TIGHT BINDING BOOK

THE ECONOMIC PROBLEM

BY

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LONGMANS, GREEN AND CO.

39 PATERNOSTER ROW, LONDON, E.C.4

NEW YORK, TORONTO

BOMBAY, CALCUTTA AND MADRAS

1925

PREFACE

In Economics, as everywhere in the application of systematic thought to human affairs, there is a conflict between the general and the particular. Economists, seeking to establish general economic laws, evolve simplified versions of human nature and of the circumstances in which human nature works. But when they come to apply their laws to particular cases, their conclusions are vitiated by the abstract nature of their premises.

Economic laws so arrived at have great value. They reveal tendencies and reactions which could not be studied except through the method of abstraction. But the verdict of the economist upon a particular case is never accepted as sufficient, because these tendencies and reactions do not tell the whole story. When account has been taken of all general principles with any bearing on the case, there is invariably a residue of circumstance, which does not fit into the available system of generalizations, and which can only be dealt with by the practical judgment; and the practical judgment, if too much is left to it, may be baffled by the complexity of its task.

To make economics fruitful, we need to extend as much as possible the field of systematic reasoning, and so to reduce within manageable proportions the residue left over for the practical judgment. Existing economic doctrine has or is apt to have two serious shortcomings: it presents too abstract a view of human nature, and it evades the question of the true end of economic action.

In the treatment of human nature, the "economic man" has long become a by-word. Nevertheless economists, even while apologizing for him, continue to use him. Up to a certain point he is a legitimate abstraction. His curves of marginal utility are an approximation to something which does sometimes exist. But conclusions drawn from his characteristics, though they have their intellectual fascination, go a very little way towards settling practical questions.

Apart from the economic man, the psychology employed

by economists is almost entirely empirical. Yet psychology has in recent years made great progress, and has particularly been brought into closer touch than ever before with practical life. Some aspects of this progressive and vital science can, I believe, be applied fruitfully to economics. In this book I have endeavoured to give them their proper place.

As to the end of economic action, that is of course a part of ethics. No one would propose to build economics on so shifting a foundation as the theories of moral philosophers. On the other hand to set up a single economic end such as "utility" is to divorce the subject from practical life. For every voluntary action in practical life is an essay in applied ethics. No one would guide his own conduct by an abstract principle of "utility." To understand and criticize the activities of a society of men, as well as of an individual, we must take the broadest view of the ends sought. The ends are not always on the surface. Like the *rationes decidendi* of a legal judgment, they must be inferred from the particular applications in which they are presupposed.

If it is possible to unravel the ends of individual action, it is possible to discover those presupposed in our judgments on economic matters. And when we know what the ends aimed at are, we can criticize them and can say what they ought to be. Thus it is possible to apply ethical criticism to economics, without ever having to appeal to philosophical theory, or ever leaving the plane of purely practical life.

It is ethical criticism of this character that underlies the great economic, social and political controversies both of history and of the present day. Some of those controversies are touched on in this book. They are not in themselves any part of its purpose, but they lie straight in the path which any general work on economics is bound to follow. In dealing with such controversies it has been my object to elucidate them and to bring out their illustrative value, but nowhere to make out a case. The polemics of practical controversy must have regard to the circumstances of a particular time and are properly dealt with in works relating strictly to those circumstances. But the ends and ideals presupposed in controversy are of deeper and more permanent significance.

The intrusion of ethics and psychology into economics does not mean that the subject is to be lifted nearer the clouds. On the contrary the reader will understand from the foregoing remarks, and will, I hope, be convinced by my book that it brings the subject into closer touch with the facts and interests of practical life.

The first twelve chapters are devoted to an exposition of the economic system as it is, and of its operations. It is in Chapters XIII to XV that we turn aside to the consideration of human nature. The remaining Chapters XVI to XXXI are critical and speculative.

I need hardly say that I am sensible of the magnitude of the task I have undertaken, and particularly of the impossibility of discharging it adequately without a far wider and deeper knowledge than I possess of subjects outside economics, not only of psychology and ethics, but of history, geography, anthropology and others. I firmly believe that it is only in intimate relation with this array of other studies that economics can make real progress and exercise a great guiding influence over human life.

September 1925. R. G. HAWTREY.

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CHAPTER I

THE PROBLEM PROPOUNDED

MAN is a rational animal, and if human affairs are hard to regulate, his twofold nature is usually the cause. Reason is something ultimate; it would be the same in another planet, or in another universe, as it is here. Animal nature is something contingent; it might have been different. Our life is a compromise, a blend between the animal and the rational.

If we were wholly rational, to construct society would be a problem analogous to those of mathematics. But the problems of an organism cannot be solved by mathematics. Society as it is has grown. And reason itself has grown. Our animal nature is, as it were, the soil from which both reason and society have sprung, and it has entered into their very substance.

Compare human society for a moment with animal society. The differences and the analogies are equally significant.

The characteristic of animal society is the subordination of consciousness, acute and active though it may be in some species, to the principle of adaptation to environment. The senses record a signal from outside, and instinct produces the appropriate activity. It is by instinct that animal society solves those problems which in human society we call economic. By instinct subsistence is found and consumed, by instinct attack, defence and flight are regulated, by instinct shelter is constructed, by instinct the procreation and nurture of the young are provided for. The whole process is dependent upon the environment supplying exactly the right material for instinct to work upon. There must be suitable food (animal or vegetable as the case may be) so presented that it will be sought, identified and consumed as food. For one creature the right twigs to make a nest are needed; for another the right soil to make a burrow. Instinct is highly specialized, and the multiplication

of the species is strictly limited by the extent of the environment suitable in every detail for its life. The culminating end, the ideal, to which the infinitely subtle adaptations of instinct point, is the multiplication of each species to the numerical limit that the environment allows.

One species is a factor (favourable or unfavourable) in the environment of another. All are competing directly or indirectly in the struggle for existence, in which the reward of success is multiplication.

It is characteristic of instinct not to be aware of the end for which it is working. Man also has instincts, and he, it is true. often knows their ends. He knows that hunger moves him to eat, and thirst to drink, in order to sustain him, anger to fight and fear to fly in order to secure his safety. But that is because he possesses reason as well as instinct. If any of the lower animals are similarly aware of the ends of instinct, that must be because they possess the rudiments of reason.

Reason here is to be taken in a wide sense, as meaning not merely the power of drawing inferences but the whole faculty of judgment. In the scheme of nature it is an alternative to instinct as a means of employing consciousness for the regulation of conduct, and it differs from instinct in that it foresees the end and calculates the means.

For the individual it offers a choice of ends, limited only by what is practicable and by what is calculable. That is to say, the choice is not fruitful unless the end is attainable, and unless also the means of attaining it are such as the understanding of the individual can compass.

Moreover reason offers this choice of ends not merely to the individual man but to any group of men. Here, however, there is a further limitation.

As in the action of the individual, the end must be attainable, and the means capable of being understood, but in addition the men who seek it must *act together*. The problem is one of organization. If all agree upon both end and means, and upon the distribution of tasks among them, as in a football match, well and good. The problem is solved. But it is obvious that such perfect harmony is only attainable at the best in a very limited number of instances. If human co-operation were limited to those instances, its results would be small.

When we wish to control the actions of animals, we play upon their instincts. We coax and threaten. We offer food to one; we drive another by fear. We make use of the instinct of sheep to follow a leader or of the instinct of a

horse to follow its own nose. And so with man, when the perfect co-operation which would be the ideal of reason is denied us, we turn back to instinct. We turn, however, not to instinct alone, but to the whole apparatus of human motives, instinctive, habitual or other If each member of society can be induced or impelled to do his allotted task by associating it with some motive that appears to him adequate, then he need never know how he is contributing to the real end, and need not even be aware of the end at all.

It is this problem of organization that we shall call the Economic Problem. It is in fact the real subject matter of political economy. That it is not exactly co-extensive with the subject matter as ordinarily defined may be admitted. The nature and extent of the differences will be further considered at a later stage.

To primitive man economic institutions were almost as immutable as instinct. In historical times we are accustomed to find labour given either in return for remuneration or under compulsion. It is rash to dogmatize about primitive man, but it is at any rate a plausible interpretation of what we know to suppose that the primitive community depended mainly upon a non-rational sense of obligation to impel the individual to perform services, of which the purpose was not immediate and obvious, but which none the less were necessary to its maintenance. This non-rational sense of obligation is the real essence of primitive religion. As man became sophisticated, first the doctrine of sympathetic magic,[1] and then mythology grew up to explain and rationalize the brute imperatives. But that is a later phase.

The field of these imperatives was by no means confined to actions which were for the benefit of the community at the expense of the individual's interests. It was necessary to prescribe for him the routine of agricultural or pastoral labour in his own interest as well as in that of the community. On the other hand the obligations of the family were imposed on him in the interest of his progeny, and the obligations of loyalty and patriotism in the interest of joint defence. Among the institutions of primitive religion a large place is occupied by rites symbolizing fertility, vegetable, animal and human. When man was not sufficiently rational-

[1] In the *Golden Bough* Sir James Frazer treats the doctrines of sympathetic magic as the most primitive interpretation of religious ritual. I hope I am not guilty of a heresy in supposing that even this interpretation is not coeval with the ritual. " Rain-making " by sprinkling water may originally have been no more than primitive man's expression of his sense of the value and function of rain.

ized to place on record in a treatise the principles of germination, the functions of sun and moisture, and the necessity of all the agricultural operations which conduced to the production of crops, this vital knowledge was embodied in sacred ceremonies, typifying, for example, the burial of a body containing the principle of vitality, followed in due course by its revival and resurrection. A stranger could hardly have guessed the meaning of the rite, but to each new generation it served to record and crystallize the experience derived from the yearly round of work.

Religion too supplied a calendar. Each festival had its appropriate time of year, and so marked the progress of the seasons, upon which the entire agricultural programme depends. Hence the prominence of the sun and moon and the zodiac in primitive worship.

These devices we have outlived. We rely instead on scientific knowledge, or at any rate on a conscious tradition. But the obligations which sustain the family and the nation have survived. To some they still take the form of non-rational imperatives; to others they have been rationalized, either as the precepts of a theologized religion, or as a moral code, expressly calculated to promote the welfare of man. But, rationalized though they be, they cannot be fully understood without reference to their non-rational origin.

There is a striking affinity between primitive religion and animal instinct. The activities undertaken in due order by the bee with such devoted persistence, in the interest of the community to which it belongs are very suggestive of observances prescribed by a religious sanction. If we imagine the consciousness of the bee developed up to the point at which she could reflect upon her own actions, she might well attribute those governed by the instinct of the hive to a sense of sacred obligation. Some instincts, it is true, like those of hunger and sex, work their way through craving. And it is probable that the sense of obligation with which we are now concerned is not really instinctive at all, but is the product of tradition, that the intensity of the belief of each generation in its religious, social and family code merely reflects the intensity of conviction with which the preceding generation taught.

The efficacy of the primitive obligations was confined to the most elementary needs, such as subsistence, defence or the nurture of children. They often promoted these ends by devious methods, and were overgrown with much that was irrelevant and promoted no ends at all. But, rude though they were, they contained the germ of development. Out-

standing among the needs of mankind is that of leadership, and it is one that figures largely in primitive religion. The most obvious need of leadership occurs in war. Primitive man, whether aided by instinct or not, may be imagined to have discovered that need with the first glimmerings of reason. But each individual could hardly have worked out for himself separately the means of meeting the need; he could hardly have seen for example, that a leader must be selected who is above jealousy, and that, once he is chosen, the rest of the community must follow the leader's command with devoted loyalty, undeterred alike by the fear of death or by doubt of the wisdom of his decisions. Such principles must somehow become established and enforced as the sacred inheritance of the whole community.

And the need for a leader was not confined to the case of warfare. Religious observances, on which the normal life of the community depended, also required someone to exercise authority and to take the initiative.

A priesthood came into existence to organize these observances, to watch the heavens and the cycle of nature, and to perform the rites that marked each season. To primitive man priest and king were one. The priest-king exacted loyalty from his fellows in virtue of his sanctity. They would obey his commands, but that did not mean that he could issue what commands he pleased. His power was limited by the religious tradition itself, which he might expound, but could not alter, and his freedom therefore was slight. Nevertheless some degree of freedom was inseparable from his position of authority. And freedom meant progress.

A leader could choose new means towards old ends, and he could choose new ends. Here then there first arises the economic problem. Civilized man has acquired an elaborate machine of government in place of the primitive priesthood. The tentative and occasional innovations and departures from routine, which were once the only embodiment of the application of reason to the affairs of human society, have given way to the highly organized and self-conscious administration and legislation that we know.

Nor is the economic problem merely one of administration and legislation. Human co-operation depends not only on authority and law, but still more on social rules, whether of morality or of custom. These social rules not only affect each individual's conduct, but they affect his *expectations* as to his neighbour's conduct.

Social rules are not so readily altered as those of law.

Nevertheless they can be altered, if the opinions of the individuals (especially of the more influential individuals) can be altered. As civilization grows, people are more and more disposed to criticize social rules, and criticism, if it is sufficiently widespread and uniform, begets change. Political Economy exists not merely to advise governments and legislatures, but to influence the development of social opinion.

The economic problem, then, is that of utilizing man's capacity for joint action. It includes the selection of ends and of means. The means can only be the actions of individuals, and the action of the individual is regulated by the motives in his own mind. Whatever institutions, political and social, may be set up, their method must always ultimately be to play upon human motives. And the choice of ends is limited to those which can be attained by such means.

The problem of so employing human motives in the interest of joint action is one of social science, as is also the problem of the limitations imposed by the nature of that joint action upon the range of ends to be selected. But the problem of selecting the ends within these limitations is one not of science but of philosophy.

The whole subject might perhaps be treated as a department of philosophy. The choice of the ends of joint action might be put in the forefront, and the examination of the best methods of utilizing human motives to pursue the ends might follow as a consequential and subordinate part of the investigation. But even if philosophy were qualified to pronounce *a priori* as to the ends with any certainty, our understanding of human nature does not extend far beyond recorded experience. We are practically compelled to follow an *a posteriori* method. We must find how human societies are and have been organized, what institutions and customs have prevailed, what ends have been sought and with what success Our modest philosophizing will not go far beyond a criticism of the ends and means disclosed.

CHAPTER II

THE INDIVIDUALIST SOLUTION

THE economic problem is the problem of joint action by a community of men. The life of the community requires that the individual members composing it render certain services, which their own immediate interests or instinctive impulses would not prompt them to do. The means once found of inducing them to render such services, the same solution, can be applied to other activities which, though not necessary, are advantageous.

Man, the animal, depends on his environment. But he differs from other animals in several respects. In the first place he can make different environments suit his needs. Secondly he can modify or improve his environment. Thirdly he can use the resources of trade and transportation to make each of two regions supplement the deficiencies of the other.

Of these three, the first, man's power of making different environments suit his needs, is not dependent on joint action, but results from the rationality of the individual itself. Each of the lower animals is restricted to the area in which its own special food is to be found; one must have a particular kind of flesh; another a particular kind of fruit, of grass, of insect, or of fish; another depends entirely on the young shoots of a particular kind of tree. Man on the other hand, wherever he finds fertile ground, will always devise the means of making it yield him subsistence. If he cannot feed on the indigenous products (vegetable and animal) he will plant crops brought from elsewhere to suit his tastes, and will rear animals which he can eat. The processes by which he has developed his staple crops and domesticated beasts are hidden in prehistoric clouds. Whatever they may have been, we have the present fact that almost every variety of climate and soil that is fit to yield organic products at all can be made, within the limits of its fertility, to support man.

The second characteristic of man's relation to his environment is his power of modifying or improving it. This really overlaps with the first, for the introduction of new crops or livestock is itself a modification of environment. The nomad who drives his flocks and herds before him is improving his environment, for of that environment the flocks and herds themselves form part. But there is a difference of kind between the nomad's influence upon environment and that of the cultivator. The cultivator commits himself to improvements *fixed in a particular place.* Without such fixed improvements, human life must remain elementary, and little removed from that of the animals. And how large a place have these fixtures played in human history! It is they, the cleared and cultivated lands, the houses, and other buildings, the means of communication, the multifarious plant necessary for production, including industry and mining, all the permanent and immovable improvements, that tie a human community to the locality where it is. They cannot be improvised, but must be built up gradually by generations of patient effort, and the community cannot afford to sacrifice them and start afresh elsewhere. Hence that *territorial* character of sovereignty, which permeates our political conceptions.

The third characteristic of man's relation to his environment is his power of making one region supplement the deficiencies of another. This is a special case of that great principle of the division of labour, which has been treated by Adam Smith and others as the starting-point of political economy. Within a single community each man specializes in an occupation, and is enabled thereby to attain greater skill and economy of effort than if he took up every form of production in turn. It is a necessary condition of this specialization or division of labour that each man should be enabled, whether by exchange or other means, in some degree to enjoy the products of his neighbour's work. Subject to the same condition, communities in different places can specialize each in the product most favoured by its own local circumstances.

But this local specialization requires provision not merely for distribution among individuals but for transportation or communication between place and place.

It is in the division of labour that the economic problem most conspicuously emerges. But not there alone. In directing the efforts of society, nothing that the individual does can be entirely disregarded. The activities of all are interdependent. Nor is the problem confined to man's

action upon his environment, whereby his material needs are met. In a sense the economic problem is co-extensive with human life, for, even where purely individual action is concerned, there is always the question whether the ends of society require some motive to be called in aid to modify that action. Thus the ends of society ultimately include everything in the life of all its members. That limitation of scope which is necessary to make economics a significant study at all arises from the *standpoint* from which this comprehensive subject matter is viewed. Our problem is that of *regulating* human effort. We have to find how far it is possible, and in what manner desirable to set up social or political institutions to influence men's conduct for common ends.

We may now proceed to consider what is the solution of the economic problem, which has actually been evolved from the experience of mankind up to the present time. A single logical solution need not be expected. Progress has been empirical, illumined now and then by generalizations which have had but a partial application, however completely they may have been accepted by theorists. Of such generalizations the most noteworthy, and that which has most influenced present-day civilized practice, is that called Individualism, which was formulated by the economists of the 18th and 19th centuries.

The theoretical principle of individualism is that every man shall have the right to retain the fruits of his own efforts. The division of labour is provided for by the free exchange of one man's services, or the material products resulting from them, for those of another. Subject to certain exceptions that have to be otherwise provided for, services that are for the benefit of the community must be in some sense for the benefit of its members, and under the individualist dispensation the prospect of obtaining a proportionate share of the benefit is used as the motive for rendering the services.

If everyone specializes, then the potency of the motive depends upon the attractiveness of the things for which their services or their products can be exchanged. Historically society has developed towards greater and greater degrees of specialization, and accordingly exchange has played a larger and larger part in human affairs.

The individualist solution of the economic problem entitles everyone to participate in determining the ends for which joint action is to be employed, and proportions the influence of each in determining the ends to the extent to

which his own services help to satisfy the demands of his neighbours.

The principle proved extremely attractive to the economists who evolved it, and indeed to nineteenth-century opinion generally; undeniably it has much to recommend it, its simplicity and generality, its impartiality between one man and another, its foundation in individual freedom, and finally its close approximation to actual economic practice in the most highly developed countries. It was not enunciated as an ingenious piece of *a priori* theory; it was arrived at as a generalization from the facts of everyone's experience. That the institutions of society nowhere conformed exactly to the individualist principle was obvious, but the departures from it were in many cases unjustifiable survivals of invidious privileges, or of mere meaningless shackles on liberty. In alliance with democracy, individualism made rapid progress in Europe and America. Starting as an ideal, to which Society only made a very moderate approximation, it came to represent more and more closely a generalization from the facts, just because through its own influence economic institutions themselves became more and more individualist. Very naturally, in proportion as individualism has become established in practice, its weak points have become more conspicuous, and in the past half-century the theory has been widely and bitterly challenged.

Our economic system remains predominantly and in principle individualist. In investigating or criticizing it, two contrary dangers have to be avoided. On the one hand, we must beware of treating as fundamental and indispensable practices which are merely subsidiary to the individualist principle and could be discontinued without injury if it were abandoned. On the other hand we must not take for granted the continuance unimpaired, under the guidance of some new economic principle, of practices which really depend on individualism for their working, but to which we have grown so much accustomed that we can hardly conceive their interruption

In applying the principles of individualism to elucidate economic institutions as they are, the first thing that calls for consideration is the relation of economic services to our material environment. Some economic services are independent of material environment. One man may sing to another or give him advice without employing any material means of production.

But the great majority of such services depend in some degree on material aids, and the results of many are em-

bodied in actual material objects or commodities. These material objects may be movable (e.g., articles of food, clothing or furniture), or they may be fixed (e.g., buildings, roads, fences, harbours, etc.). They may be immediately consumable, like food, or fuel, or durable, either for an almost unlimited period, like a road or a piece of sculpture, or for a limited period, like clothing or furniture.

Now by human agency matter can be modified, but cannot be created. All services of which the results are material must in the first instance have been applied to matter in some form. Whence in the individualist scheme of things is this matter to be obtained? The producer is only entitled to ownership of the results of his own efforts. If he also becomes entitled to the material object in which those services are embodied he is gaining something more. If the system is to be applied consistently he must procure the original material itself by exchange It may be admitted that the difficulty does not necessarily arise in all cases. Some material things, such as air, can be obtained in unlimited quantities by everyone. But this is not the rule and, even most things of which it is true, such as water, stone or the soil, can be procured more conveniently from one place than from another. Who is to have the privilege of drawing supplies from the most convenient source? And in the more general case, where supplies are not unlimited, how are they to be distributed. The individualist's impartiality among persons leads him to say that the natural resources of our environment are themselves to be acquired by exchange. They must therefore be a subject of ownership. The ownership might be that of the State, but the economists of the nineteenth century, looking around them, found the land everywhere in private ownership. Here and there the State happened to possess properties, which yielded a reinforcement to its revenues, and which it managed on principles carefully imitated from private landowners. But private ownership was the rule, and European colonists were accustomed to apply the same rule to the new regions which they occupied in other continents.

Private ownership of land was a modern development. Into its history it is not necessary to enter at this stage. It is enough to point out that any common land system, with its complexity of rights and duties, is inconsistent with the individualist ideal, whereas state-ownership, so long as the privileges of tenancy are treated as a subject of free exchange, is not.

Given land-ownership, including State-ownership on this

condition, all useful material objects, which can be held in human control at all, become subject to rights of possession or property. As a result any fixed improvement in the environment inheres in some one's property. It can only be made either by his direction or by his leave The general principle of individualism would rely on the advantage to the landowner as a motive for the undertaking of improvements. Cases, if there are any, where improvements are necessary or desirable in the interests of the community, but of no advantage or no adequate advantage to the landowners affected, must be dealt with exceptionally.

Within the limits of individualism there is room for a great variety of different methods of placing the material means of production at the disposal of those who have to work upon it. Three simple cases may be distinguished. In the first place the workers may themselves own the means of production. Secondly they may borrow or hire them. Thirdly the owners of the means of production may hire the services of others to work upon them And likewise the relations among the workers themselves vary. There may be a single producer on his own account, whose services are rendered independently of those of any others Or a number of workers may co-operate. They may collaborate as partners, or they may be employed by one master.

Through all the varieties of organization there runs the individualist principle of free exchange. Every man makes whatever bargain he thinks will bring him the greatest advantages, whether from the services he is able to perform or from the use of his property. Before probing further into this question of the organization of production, it will be convenient to turn to that of exchange.

CHAPTER III

THE MARKET

THE practical application of the principle of individualism is entirely dependent on the practice of exchange In theory, it is true, a society might exist without division of labour and without exchange, every man performing the services, and producing the commodities, which he himself requires. Such a society would conform to the principle of individualism, in that it would reserve to every one the reward of his own services. But if human society were fit for no more than this, there would be no economic problem among men, any more than among rabbits.

Given the division of labour, then there must be exchange. The division of labour is not merely a device for gaining greater efficiency through specialization. It may have begun so. If the blacksmith gives his whole time to his forge, and the cobbler to his bench, their work will be better done than if every man does his own forging and cobbling. But the division of labour means much more than that. It includes all those cases where several men contribute different services towards a single task. This may be because the task is too great for the capacity of a single man. Or the task may be the production of some commodity, which can be made in far greater quantities with a given effort if the separate operations required are allotted to different workmen. It is the sub-division of work into simple operations that makes the use of machinery, with all the consequent economy of effort, possible.

Finally, it is only through the division of labour that the resources of different, and it may be widely distant places can be combined in the creation of a single finished product.

In an individualist society where the division of labour prevails, what the individual produces is for the most part of no direct use to himself, and he can only procure his

share of the resources of the community by offering his own products in exchange.

It is the interest of him who has anything to exchange to find among his neighbours that one who will give the greatest amount of other things for it. A search for the most favourable offer might well be long and laborious. He can hardly ask all his neighbours in turn whether they want the article to be exchanged and what they will give for it. He will rather endeavour to make his own offer as widely known as possible, and trust to those who wish to take advantage of it taking steps of their own accord to state their terms. But if one man is doing this, it is to the interest of all others in the vicinity who are trying to dispose of articles of the same kind to come and do likewise. They all want to seek out the most favourable offers from among their neighbours, and no one of them can afford to stand aside while another is finding these offers and taking advantage of them. It is for the convenience of all that they should act together, and place their wares on offer under such conditions that every one will know where to seek them. It will then be a matter of common knowledge that the commodity in which they deal is to be obtained from them, and no one of them need act alone in obtaining publicity or seeking out buyers

Open dealings so concentrated and organized form what is called a *market*. The effect is to *remove inequalities* between the terms on which different exchanges are effected No one will be willing knowingly to give more or to receive less than his neighbour exchanges for any article.

When one commodity is exchanged against another, each is said to be given thereby a *value*, or, more precisely, a "value in exchange," in terms of the other. The value of any commodity in terms of another is the quantity of the latter exchanged for a unit quantity of the former. It is thus a relation or proportion between the two quantities exchanged. If a pint of beer is exchanged for two pounds of bread, the value of beer in terms of bread is two pounds the pint, and the value of bread in terms of beer is half a pint the pound.

Value so defined is an incident to a single exchange. But, in virtue of the equalizing effect of the open market, the value in exchange between any two commodities tends to be the same in all dealings at the same time in the same market. If the open market works perfectly, and the inequalities are completely removed, the result is a single uniform *market value* between any two commodities dealt in.

A market organised upon the basis of barter, with separate quotations of the value of every commodity in terms of every other, would be impossibly complicated. But these relative values are not all mutually independent. The same equalizing process, which makes the value of one commodity in terms of another uniform in the open market, will make the relative market values of all commodities *mutually consistent.* If one commodity is exchanged for another and then this second for a third, the market values must tend to be such that the same amount of the third is obtained as if it had been received directly in exchange for the first. Suppose therefore that one standard commodity (such as gold or silver) is selected, and the market values of all others in terms of it determined. Then the value of any commodity in terms of any other will simply be the proportion between their respective values in terms of the standard commodity

To secure this very necessary simplification, it is not really necessary even that there should be a standard commodity, so long as there is a *common unit of value* Such a unit of value is what is called a " money of account."

But the standard commodity, where it is used, serves to provide not only a unit of value but also a medium of exchange. Instead of every commodity being offered in the market in exchange for every other, every commodity is offered in exchange for the standard commodity. The dealers who receive the standard commodity in the course of their exchanges do not in general require it for its own sake, but only in order that they may offer it in turn for the other commodities that they need. The standard commodity plays the part of *money*. It is perhaps hardly necessary to point out that the medium of exchange need not necessarily be a commodity, but may be a mere token, legally established as a medium of exchange, and otherwise of no value, like paper money.[1]

Commodities and services are offered in the market for money, and each tends to have a definite market value in money, or market *price*. Nearly every responsible person in the community is both a producer and a consum[illegible] seller and a buyer. But selling is a very differe[illegible]tion from producing. If the producer has to gi[illegible] and thought to finding buyers, and labour to carry [illegible] his produce to market, he will find his regular occupation interfered with. Likewise in his capacity as consumer he cannot afford to give up an indefinite amount of time to finding

[1] As regards the use of bank credit, see below, Chapter V

what he wants to buy and agreeing a price. If society develops beyond a primitive simplicity, in which exchange takes a relatively subordinate position, it becomes imperative to relieve the main body of people of such encroachments upon their time and thought. The need can be met by a further application of the division of labour. Marketing must be itself made a separate occupation.

Those who engage in this occupation might confine themselves to the functions of brokers or agents, establishing communication between buyers and sellers. But the consumer frequently wants to see a thing before he buys it, and, if he is to be enabled to do so without excessive travelling, the goods for sale must be scattered over the country as the consumers themselves are scattered. The consumer wants to buy in small quantities. To buy in large quantities means, on an average, to have correspondingly large stocks of goods in hand, and apart from cost of storage and risk of deterioration, the mere holding of unnecessarily large stocks is itself a loss. The holder has made sacrifices to acquire the unconsumed stock, but till he can consume and enjoy it he gets nothing from it in return.

If the consumer is to be enabled to see what he wants to buy without journeying far from home, and to buy in small quantities, then it will be impossible to limit the functions of the people who carry on the market to those of a mere broker or go-between For that would mean that the producer must retain his property in the product through all the processes of transportation and subdivision till it is finally disposed of. The marketing of commodities in fact is in general placed in the hands not of brokers but of *dealers*, who buy the commodities outright from the producers, and hold them till they can be sold to the consumers, though in some markets brokers are employed to facilitate transactions between dealers.

Among the dealers themselves there is a differentiation of function Retail dealing, the ultimate selling to the [illegible]ners, is decentralized. It is localized in numerous [illegible] and [illegible]ing the distribution of the consumers themselves [illegible]ented, it may be, if the population is very scatter[illegible] [illegible]riodical fairs or itinerant vendors. To the producer it w[illegible]d often be only one degree less inconvenient to sell to the multitude of retail dealers than to sell direct to the consumers. Therefore between the producers and the retail dealers there intervenes another set of intermediaries, the wholesale dealers or merchants.

The distinction between producers and wholesale dealers is not always consistently maintained. A producer, especially a producer on a large scale, sometimes also acts as a merchant, in that he sells his products direct to the retailers. This is especially common with proprietary articles of which the brand is made familiar to consumers. But where the consumers' and therefore the retailers' demand is not directed to any specified brand, a dealer who can only supply them from one source is at a disadvantage They will prefer to buy from one who can obtain the goods from many alternative producers. The market may be regarded as an organization for "clearing" supply against demand. Each dealer is in touch with a number of sources of demand and a number of sources of supply. Whenever he finds that he is left with an excess of demand or an excess of supply, he seeks a dealer with a compensating contrary excess. The market is so organized as to facilitate the communications between dealers by which such compensating transactions are carried out.

The clearing of supply against demand imposes upon the dealers two important functions: the holding of stocks of commodities and the transportation of commodities from place to place.

A dealer buys from one man and sells to another, and in the interval between buying and selling the commodities are his property. The stock of commodities thus held by dealers at any one time must for a variety of reasons be large.

In the first place the time occupied by transportation from producer to consumer must be considerable. The local distribution of the producers of any commodity, depending on the facilities for production, will have no relation to that of the consumers. The producer when he sells to the dealer is quit of his product, and it is for the dealer to arrange for transportation. Transportation can usually be effected most economically if large consignments are sent at a time. This is so by land, still more by sea. The problem of distributing the supply of any commodity to the consumer involves ultimately dispersing it throughout the community, following the distribution of the population. In the process the big consignments must be broken into, but it is advantageous to keep them together as long as possible. Stocks are probably sent in the first instance to principal centres or *interposts*,[1] and thence to subordinate centres for further

[1] This word, which was apparently used in the 17th century as the English equivalent of the French *entrepôt* seems worthy of being revived.

distribution, till at last they appear in the shops within the consumer's reach

Where production is continuous, as in the case of most manufacturing and mining industries, the product will be carried away in suitable consignments at convenient intervals. But in the case of many commodities, especially farm crops, the production is seasonal. If there is one harvest a year, then immediately after it there is a stock, to be held either by producers or by dealers, equal to a year's consumption.

But independently of the exigencies of transportation and production, the business of marketing itself leads dealers to hold stocks of commodities.

For example a retailer wants, as far as possible to have ready to hand in stock anything, within the limits of his business, that a customer may ask for. He will accordingly keep in stock a certain quantity of every article he deals in, and, when the stock of any one article is approaching exhaustion, he will order some more from the wholesale dealer. To secure economy in transport and handling, and to avoid having to give too frequent orders, he will order a considerable quantity at a time. His *average* stock will be something intermediate between the lowest quantity to which he lets it sink, and the maximum to which it rises when an entire fresh order is added to this minimum.

The wholesale dealer must be prepared to supply the requirements of the retailers. These requirements correspond approximately to the retailers' own sales. The sales depend on the action of the consumers, and can be estimated in advance, but cannot be exactly foreseen. If the wholesale dealers are to be sure of supplying the retailers punctually, they must keep some stocks in reserve, to provide for an unexpectedly rapid sale of any one or more commodities.

Suppose such an unexpectedly rapid sale to occur; what will be the result? The reserve stocks of the commodity affected will be diminished, and the dealers will be less prepared to meet a similar emergency till their stocks are made up again. To reconstitute their stocks they may either order more from the producers, or they may ask a higher price from the retailers, who in turn will ask a higher price from the consumers.

And that brings us back to market price. We have now sketched the organization of the commodity markets. How is that organization in practice applied to determine market price?

The price of anything measures the quantities of other things that may be had in exchange for it. In an individ-

ualist community, where there is division of labour, people work, not for the sake of their own products, but for the sake of the things for which those products can be exchanged, and the inducement to produce is therefore measured by the price of the product. In general the price received by the producer is paid him not by the ultimate consumer but by a dealer. Often the dealer will sell to another, and the product may change hands several times before it reaches the hands of the retailer who disposes of it to the consumer. All the transactions lead up to this final sale. The producer and all the intermediaries who buy in order to sell again depend for the fruit of their efforts on the price paid in the end by the consumer, whose purpose in buying is not to sell again, but to enjoy or to possess. The natural sequence of events would seem to be for the consumer to start the process of production by giving an order for whatever he needs. But in reality it is altogether exceptional for the consumer to take the first step, so exceptional that in an outline sketch of the organization of markets the case where he does so can be disregarded.

The consumer is *passive*. For this there are a variety of reasons In the first place human beings do not easily *originate* anything. Consumers in general are not competent to take the initiative, even in promoting the satisfaction of their own wants. The man who has the faculty of doing so will probably find it worth his while to make use of his talents not only for his own benefit but for that of his neighbours. He may become a dealer, and plan the satisfaction of the needs of those who are not in a position to look forward on their own account.

Secondly, even those who have the gift of initiative cannot as a rule spare the time and thought necessary to use it for the satisfaction of their own wants. Here and there we find one who can. One man will have furniture made from his own specifications to suit his tastes. Another will insist on having all his clothes made according to his own directions. But these are serious activities, only to be undertaken by those who have the requisite leisure, skill and resources.

Far the greater part of the commodities available for the consumer are produced in large quantities after uniform patterns. If the consumer is to have the advantage of the cheapness obtainable only by large-scale production, he must be content with the same pattern as his neighbours. The pattern will be originated by no one of the consumers, but either by the producers themselves, or by the dealers who order the articles from them.

Further, even where the product is not manufactured in mass, but each article is produced separately, and has individual qualities, the consumer may still prefer to see the completed article before he buys it, rather than commit himself by ordering it from the producer. Here too the initiative will be left either to the producer or to a dealer. In general therefore the specifications of the things that the community is to produce are made out not by the consumers, from whom the demand proceeds, but by the dealers. The tastes and preferences of the consumers will undoubtedly influence the dealers, who will endeavour to anticipate the demand for any class or pattern of article, and to be ready to meet it. The consumer will find in the shops around him a wide and varied assortment of things produced in compliance with the different dealers' views. Within the limits of that assortment, he can exercise his choice and can influence production. The things preferred by the consumers will be bought in greatest quantities. The extent of the demand will be forthwith signalled by the retailers to the wholesale dealers, in the form of orders for the replenishment of their stocks, and so to the producers. But that only applies to those classes of things which have already been produced and put on sale. The consumers are not in a position of themselves to start any *new* departure in production however slight.

We have seen that it is the function of a market to establish uniform prices. If the retail market worked quite perfectly, there would be at a given time one determinate price for the same article throughout the district served, subject only to variations due to shopping amenities, facilities for the delivery of goods, and similar minor utilities. In practice there are many imperfections. The shops which together constitute the retail market in a populous centre are very numerous, and those who enter one to buy have a very limited knowledge of what its competitors can offer and what prices they ask. To compare the prices with those charged elsewhere is itself by no means a simple matter, involving as it does a judgment as to the quality of the things sold. One of the most important services which the consumer asks of the retailer is to classify and grade his wares accurately and honestly, and only experience teaches which of the retailers can be relied on in that respect.[1]

[1] A most necessary faculty in a dealer, wholesale or retail, is discrimination in judging the grades and qualities of the things he deals in. It is a faculty not to be easily acquired, and one which can be carried to a high pitch of refinement.

In many parts of the world there is hardly even a pretence of uniform prices in the retail markets. Everyone who enters a shop expects to have to go through a lengthy process of bargaining before he can settle the price at which he is to buy. The price first quoted is merely the starting-point of the haggle. That means that the division of labour, so far as marketing is concerned, is imperfect; a part of the business of dealing is left to the consumer instead of being undertaken by the professional dealer. Nevertheless the tendency is still towards a determinate market price. The shopkeeper and his customer are both guided by their respective beliefs about the market. The one will refuse to sell if he thinks that he will get other offers to buy at a higher price; the other will refuse to buy if he thinks that he can buy at a lower price at other shops. Their manœuvres are influenced by many considerations. Each may presume on the other's ignorance of the market. The shopkeeper may be willing to keep his goods unsold for a time in the hope that demand will improve. The customer may prefer to do without the thing he intended to buy, rather than buy it at a price which he cannot afford, or which he thinks unreasonable.

In the end the bargains approximate to a standard market price, and the departures from the standard arise from the ignorance or negligence of the purchasers (and in a less degree of the sellers) in regard to the conditions of the market.

The same is true of prices arrived at by auction. Sale to the highest bidder seems at first sight to be the elemental type of market dealing. But in reality it is usually a very imperfect method. Not only is its extent limited to the people actually present at the sale, but in practice the bids are very largely dominated by the standard of market price. Even where consumers bid, along with dealers, it does not follow that they are typical consumers, nor, even if all the consumers in the market could be brought together at a single auction, would they necessarily be able there and then to form reasoned judgments as to the prices at which they themselves find it worth while to buy.

The best organized retail market is that in which goods are placed on sale at determinate uniform prices for selection by the consumers. When the demand for anything in a market at the existing price grows, and the stocks are diminished, the dealers may either replenish their stocks by ordering more from the producers, or check demand by asking a higher price. Almost certainly they will prefer the

former course, so long as it is available. A rise of price is hardly ever practicable, so long as production can be increased without any increase of cost; for if one dealer raises his prices, and another secures an increased supply at the old price, the latter will get all the business. Prices might be raised by simultaneous concerted action on the part of all the dealers. But that would be precarious, because their action would conflict with the interests not only of the consumers but of the producers, and also with those of any dealer who chose to remain outside the ring.

In the first instance therefore an increase of demand may be supposed to be met by an increase of supply. Sometimes an increase of supply can be provided without any increase of cost and an increase of demand that does not exceed the limits within which this is possible will not affect price. But sometimes those limits will be passed, and that possibility raises the question of the relation of price to cost of production.

We shall have to consider the conditions of supply and cost of production more closely later on. Here it is enough to point out that crops differ materially from other products in regard to the reaction of price upon supply. The general principle that the offer of a higher price to the producers evokes an increased supply, whereas a fall of price checks supply, is clear, but in the case of crops subject to an annual harvest it can only work very slowly. Dealers, faced with the irresponsiveness of supply, have to regulate demand by suitable adjustments of price. The prospect of scarcity enables them to ask a high price, while the prospect of plenty leads them to sell off at a low price. For manufactured products or minerals the supply can be more rapidly adjusted, and smaller price changes suffice to secure equilibrium. The general principle, accepted by all the economists, that the market price will tend to be that which just equalizes supply and demand is beyond question. But its application to practical affairs is beset with complexities.[1]

Every dealer's action will be affected by his opinion of the future course of demand, of supply and of prices. An increase or decrease in demand, recorded by an increased or decreased volume of purchases, may be fortuitous and fleeting, or it may be the first symptom of a prolonged or even a permanent change. In the former alternative the whole movement can probably be absorbed in a change in stocks,

[1] There is an interesting analysis of the working of demand in Mr. G. B. Dibblee's *Laws of Supply and Demand* (see especially Chapter XII).

and stocks can be restored to normal by a suitable adjustment in the rate of production, without any disturbance of the market or even a temporary change in price. If on the other hand there is to be a lasting change in demand, the dealers who fail to recognize the portents in time may suffer serious loss.

Suppose that the demand for some commodity is increasing. The dealers will order increased supplies. Presently, the capacity of the producers will begin to be strained, and they will ask a higher price. Some dealers, expecting the increased demand to last, will nevertheless go on ordering supplies; others, expecting the demand to fall off again, will withdraw. If the former are right, the latter will find that they cannot get supplies when they need them, and, besides losing the direct profit that they might have secured, may suffer a permanent impairment of their business connexion. If, on the other hand, the demand does fall off, those dealers who persisted in giving orders will find themselves loaded up with stocks, which they can only sell at a sacrifice.

Or again, where it is not an increase but a decline in demand that is in question, the dealers will cut down their orders to the producers, and if the falling off of business goes beyond a certain point, the producers will offer supplies at a reduction of price. If the decline in demand proves to be transitory, a dealer who foresees this may make a large profit by laying in supplies under favourable conditions. But if the decline in demand proves to be permanent, the reduction of price on the part of the producers may be insufficient to save the dealer who has bought too freely from embarrassment and possibly from heavy loss.

The wholesale dealers therefore will do their best to read the signs of the market. They will endeavour to penetrate the secrets of the consumer's mind, to find the real causes of the change in his purchases, and to tell whether those causes are transitory or permanent.

One dealer does not know another dealer's affairs, but will be inclined to draw inferences from his actions. If one dealer makes an advance in prices, or enters into large purchases, the others are apt to infer that he at any rate expects an expansion of demand. They may be led straightway to do the same, so that the rise of price, instead of checking demand on the part of the wholesale dealers, would actually stimulate it. Even the consumers themselves may quite possibly be influenced in the same way; they may regard a rise or fall of price as the precursor of a greater

rise or fall, and may accelerate or retard their purchases in consequence. But the consumers' stocks are relatively small, and will not remain for long appreciably above or below normal. Changes in demand through the consumers' anticipations of a rise or fall of price are likely to be slight and transient.

As a result of the dealers' continual efforts to adapt their actions to the future course of the market, and of their inevitable miscalculations, there will be frequent divergences of their stocks from normal. Whenever such a divergence occurs, prices will be influenced by it. If stocks are inconveniently large, dealers will try to sell them off, and prices will fall; if stocks are short, dealers will increase their orders to the producers and will check sales by raising prices. The possession of a stock which is capable of a certain amount of variation is almost indispensable to a dealer, for it gives him time to watch the market and interpret its tendencies.

Some commodities, such as fruit or flowers, are so perishable that they cannot be held in stock for more than a few hours. They must be sold within that limit of time or not at all. The market in such commodities is characterized by violent fluctuations in price, and by a frequent complete exhaustion of supplies.

In the normal case, where the maintenance of a stock large in proportion to a day's demand is feasible, the equation of demand and supply is not exact; the difference over any period of time between demand and supply is equal to the change in stocks (subject of course to wastage). In the long run the change in stocks must be negligible in comparison with production and consumption. But within the limits of a period long enough to secure that result, the state of supply and the state of demand may both have changed several times. For practical purposes the effect of stocks upon markets cannot be neglected.

The market price of a commodity is the resultant of the dealers' opinions as to the present and future state of demand and supply. By the "Law of Averages" the miscalculations of a number of dealers will be less than those of any one of them. Where the data for forecasting demand and supply are really insufficient, the law of averages will not save the market from error, and changes of price will be delayed till the state of their stocks forces the dealers to take action. For, so long as there is no tangible reason to anticipate a change of price in one direction rather than in another, the opposite expectations of the different dealers, based as

they are on pure hazard, will tend to cancel out, and the net effect will be no change. If there is a mob of dealers following the lead of one or two, the advantages of the law of averages are lost, and the miscalculations are exaggerated (unless the few who lead the market have the skill and the power to make a materially more accurate forecast than the crowd).

In general, where the dealers in a market, whether from want of data or from want of skill, fail to foresee conditions, prices will remain undisturbed for a considerable period, and will then suffer violent oscillations, till a level has been found, by the method of trial and error, at which demand and supply appear to be equalized.

The only safeguard against such disturbances is the intervention of expert speculators, that is to say, speculators who make a special study of the indications of future demand and supply, and try to estimate an equilibrium price which takes the future conditions into account. If the speculators foresee a shortage, they buy so long as the present price is below what they believe to be the future price ; if they foresee abundance, they sell so long as the present price promises a profit. These purchases and sales are not, or at any rate need not be, accompanied by the physical delivery of the supplies dealt in. All that the speculator need do to affect the course of the market is to *pledge himself* to a purchase or sale of a specified quantity at a named price on a future date. What he sells is counted by the purchaser as part of his available stock ; what he buys is counted by the seller as disposed of. Bull speculators affect a market in the same way as a diminution of stocks, and bear speculators in the same way as an increase of stocks.[1] But when the period of speculation comes to an end, the effect on prices is reversed. The bulls must either accept delivery of the stuff they have bought or sell it in the market. The bears must either settle with those to whom they have sold for a money payment, or buy the necessary supplies in the market.

If the speculators are skilful, they will anticipate changes both in supply and in demand, and changes in price will be gradual instead of violent. *Unskilled* speculation on the other hand may actually accentuate the price oscillations. For amateur speculators are apt to snatch at any conspicuous circumstance as a pretext for buying or selling,

[1] For the benefit of readers who are unfamiliar with the slang of the markets, it may be mentioned that a bull speculator is one who buys in the hope of a rise of price and a bear speculator is one who sells in the hope of a fall.

and when many are guided by the same error its effect is exaggerated and the saving influence of the law of averages is lost. But the best corrective of unskilled speculation is skilled speculation.

It occasionally happens that a change so profound and so sudden occurs, either in demand or in supply, that the market is for the time being completely paralysed. Dealers are so entirely at a loss with regard to the future equilibrium point, that they are afraid either to buy or to sell. Whoever would buy or sell must negotiate a price with some individual dealer, and, if he seeks a competitive price, must negotiate with one dealer after another, only to find perhaps, that by the time he has decided to accept an offer, the offer is withdrawn, and he must start negotiating afresh. Such breakdowns occur especially in time of war, during financial crises, and above all in the event of a monetary collapse.

CHAPTER IV

THE LABOUR MARKET

PRODUCTION means action which results in the existence of something that did not exist before. As we have already seen in Chapter II, the product may be, but will not necessarily be, a material object. It may be a service rendered to the consumer himself, for example by a domestic servant, by a doctor, by a railway company, by a theatrical company, by a cobbler, by a schoolmaster, by a Government department. But even where the product is a material object or commodity, the process of production consists of services rendered. The people who render these services depend for their remuneration ultimately upon the exchange of the product.

The case, which under the conditions of the present day has become exceptional, where one man buys his material, applies to it the productive processes single-handed, and himself sells it to the consumer, differs but little from that of a service rendered direct to the consumer. But we have already shown how a commodity may change ownership, and pass from producer to dealer, and from dealer to dealer, before it reaches the consumer. The process of production is profoundly affected by the ownership of the material objects used. The application of the process to such an object is in fact a service rendered to its owner, and in the usual case, where a number of workmen and supervisors co-operate in production, all are in the employment of the owner of the material upon and with which they work. It is he that we shall call the producer.[1] He intervenes between them and the purchasers of the finished product, as if he were a dealer. But he is not a *mere* dealer. For he does not merely buy labour and materials to sell again. He directs the application of the labour to the materials,

[1] Literally the term is just as appropriate to his employees who perform the actual labour of production. But the usage here adopted is in some respects more convenient.

and the resulting product, which he sells, is something different from either. His task is primarily one of organization. Though he both buys and sells, he is not a specialist in marketing. He may be content to produce whatever the wholesale dealers choose to order. He trusts to them to estimate demand. The dealers do the staff work, while the producer is the regimental officer. They plan the campaign; he carries it out.

A producer, however, cannot divest himself of responsibility for foreseeing movements in demand. The productive capacity of his plant is limited. And, while he cannot produce more than the limit, to produce appreciably less is to waste part of the value of the plant.

When demand for a commodity grows, and increased orders emanate from the dealers, the producers, one after the other, are filled with work up to the limit of their capacity. When those in a position to accept orders, and to undertake delivery in a reasonable time, have become few, it becomes possible for the producers to raise prices against the dealers. But it is for the producers themselves to judge when the time has come for this.

Likewise when demand flags, and orders fall off, it is for the producers to decide whether it is worth while to offer to supply goods at a lower price, in order to keep their plant occupied and their workmen employed.

In taking these decisions, the producers have to make the same sort of calculations as the dealers. But their point of view is somewhat different. They are in less direct touch with demand, which they only feel through the medium of the dealers; demand for them means wholesale demand, and diverges from the actual daily sales of commodities for consumption to the extent that the dealers, retail and wholesale, allow their stocks to vary. The judgment of the market as to the tendency of consumption and of prices is therefore already expressed in the wholesale demand, as transmitted to the producers. On the other hand the producers are in closer touch than the dealers with the various factors affecting the volume and cost of production. It does not necessarily follow that they will know more about these factors or exercise better judgment in regard to them than the dealers. It is as much the function of the dealer to look beyond the producer to the factors affecting supply, as to look beyond the retailer to the factors affecting demand. One dealer buys from many producers, and his outlook is wider than that of any one producer.

But the producer is a buyer as well as a seller. In buying

materials he enters the market as a dealer. But he must have regard not to a sale of the materials, but to a sale of the finished product into which the materials are to be worked, and to the relation of their cost to the selling price of the product.

Besides buying materials, he buys labour. And that brings us to one of the most essential parts of the economic system, the labour market. The economic system is an organization of human effort, and far the greater part of humanity can bring nothing but effort to market. The average man is a seller of his own services, and a buyer of commodities, and it is no easier for him to be a specialist in the art of selling the former than in that of buying the latter.

A professional dealer has two great advantages. He knows his market, and he holds a stock. If the state of the market so requires, he can continue buying and defer selling, or he can continue selling and defer buying.

The workman, selling his labour, cannot really know the market. His business when employed is to perform the task allotted to him, and his leisure is much too precious to be devoted to studying someone else's business, even if he could get the opportunity of doing so.

That which he sets out to sell, labour, is a thing of which there cannot be an accumulated stock. What he withholds from sale to-day cannot be sold to-morrow, for labour is more perishable than cut flowers. To-morrow to-day's labour will no longer exist: he cannot afford to wait, and he is only too likely to sell his services at a price below that which the market, properly approached, might yield him.

Nevertheless, even in communities where the workmen remain completely unorganized, custom does something to mitigate these disadvantages. There is likely to be in each trade a customary rate of wages, which is not easily or often changed. This customary rate, or market price of labour is generally known, and to that extent the individual workman's ignorance of the market is mitigated. But that does not mean that he has any knowledge of the profits secured by his employer or by the dealers through whose hands the goods produced will pass on the way to the consumer. Nor has he the means of judging what would be the effect on demand of the increase or decrease in cost of production corresponding to a possible change in his own wages. The customary rate of wages may be lower than that which the market might yield to a well-informed and powerful body of organized

bargainers. It might on the other hand be higher; whether this would be clear gain to the workmen or whether they would lose in irregularity of employment what they would gain in wages is a question which we are not yet ready to consider.[1]

A remedy for the disadvantages of the workman in bargaining has been found in the organization of labour in trade unions. Instead of leaving wages to be settled by custom, the workmen unite to appoint accredited representatives, who from time to time meet representatives of the employers in the industry, and deal with the question of wages from the point of view of the industry as a whole Trade union officials can afford to give time to examining what wage-costs the industry can bear, and are better informed than the individual workmen, when they come to bargain with the employers.

It is not possible to avoid the loss to which the workman is exposed if he withholds his labour rather than accept what he regards as inadequate remuneration. He may possess savings on which he can live while he is seeking for a better offer, but meanwhile the savings are being used up. He does not escape the loss Workmen organized in trade unions subscribe to accumulate a joint fund, especially to be used for their subsistence, should they decide to enforce demands upon the employers by a concerted refusal to work. But the subject of strikes is one which we can deal with more conveniently at a later stage.

The trade union performs for labour one of the functions which the merchant performs for commodities, that of determining the market price. But it cannot also play the merchant's part of intermediary between buyer and seller. The workman sells his labour direct to his employer, without any intermediary.[2] If employers are left to seek workmen and workmen to seek employers at haphazard, there is bound to be great waste of effort. Unfortunately, this waste does only too often occur. Nevertheless, it can be avoided, or at any rate very much diminished by the intervention of agents, who receive the applications of employers and workmen, and bring them together. Such agents offering their services for remuneration by fee or commission have long existed for certain occupations, and in recent times a great extension of the system has taken place in several

[1] See below, Chapter XXVII.

[2] This is not true without exception For some kinds of work labour is organized in gangs whose services are sold by a leader. Slave-dealing of course is also an exception.

countries through the establishment of Employment Exchanges under the direct authority of the State

Whether settled by custom or by collective bargaining, there tends to be in each industry a determinate market price of labour. And the labour market for one industry cannot be dealt with in isolation. There is fundamentally a single market for all forms of labour, though it is not an absolutely free or perfect market. Every industry competes with every other for labour. Not only do the new recruits from among the youth of the community exercise a certain amount of freedom in their choice of a calling, but some even of the the people established in industry can find opportunities of changing. To change is to take a risk, and besides the difficulty of adapting the skill and experience acquired in one industry to the conditions of another, there are often conventional obstacles to such a change. There may also be conventional limits placed upon the number of young recruits that may enter an industry. All such obstacles to the entry of new workmen into particular industries tend to impair the unity of the labour market.

The labour market is also subject to local limitations In order that the labour market within any area may be really *one*, workmen must be able and willing to move freely from one part of it to another. This is not entirely a question of transport. Additional population cannot be settled in a locality till the necessary house room has been provided for their accommodation, and the necessary fixed capital for their employment. Nor are people willing, except for strong reasons, to leave the society they know, and enter a community of strangers. Where by these and other causes the mobility of labour is interfered with, there is not a single market, and glaring inequalities in the remuneration of labour may persist between one place and another.

Within limits, where labour moves readily from industry to industry and from place to place, there may be a single free labour market. But that does not mean that the remuneration of all forms of labour will be equal. That would only be so if the aptitudes and training required in each occupation were invariably obtainable without difficulty. The remuneration that an employer is prepared to offer in the labour market for any particular form of skill depends on the price that he may expect to get from the product in which the skill will ultimately be embodied. If the supply of the product is limited by the scarcity of the requisite skill, that will tend to raise the price of the product, and therefore to raise the remuneration of the skill. But if the

skill is easily acquired, and there are no artificial obstacles to any one who acquires the skill entering the trade, the natural operation of the labour market will level down the remuneration by increasing the supply of the skill, and so increasing the supply and lowering the price of the product.

Thus there tends to be an approximately uniform basic rate of pay for efficient adult labour with no special skill or faculty. Picked out from this main army of labour are a number of occupations in which the remuneration is raised in varying degrees above the basic rate. In some the difference is just enough to attract workmen somewhat above the average skill, or to induce some who are not above the average to give rather more than the average time and trouble to their training. In others a remuneration a hundred times as great as that of a skilled workman offers a splendid prize to any one among the few who have the precious attainments required. Between these limits will be found every gradation of skill and training.

In the labour market all occupations are in competition with one another. Those who work for employers, whether in the production of commodities or in the rendering of services, compete with those who work on their own account, and all are subject to the market's equalizing influence.

When a man comes into the market to sell a commodity, he will seek to get the highest possible price for it. Similarly when he has chosen his occupation, and has received all the necessary training, he will in general endeavour to sell his services at the highest price that he can obtain.

But when at the start he sets out to choose his occupation, the amount of income he can expect to get from it is only one (though an important one) of many considerations that influence him. The work by which a man gets his living takes up a very large part of his life. Not only does it occupy a large proportion of his waking hours, but within limits, and it may be within narrow limits, the nature of his work settles for him the place he lives in, the amount of leisure he enjoys and the people he meets. The work itself may be more or less congenial, more or less exacting, as well as more or less remunerative.

The choice of occupation is the resultant of all these as well as many other grounds of preference. Nevertheless to most men the question of income predominates over all others, and though some inequality of remuneration may be outweighed by other advantages, that is rarely true of a great difference.

In the choice of occupation, as in the choice of com-

modities for consumption, the limitations of human initiative are felt. It is only possible for the youth who reaches working age to exercise his preference within a very limited list of callings of which it is open to him to get adequate information. Nor is it easy either for him or for his parents and other relations to judge of his fitness for any occupation of which they have no direct experience. The advice of friends, whose experience, if different, is equally limited, and who are less intimately acquainted with the youth's idiosyncrasies, goes but a little way to widen the choice.

There is therefore a tendency for the son to enter the father's trade unless there is some strong reason to the contrary. And still more is there a tendency for a community to continue in the same group of trades from generation to generation. This resistance to change is a further cause of a want of fluidity in the labour market.

CHAPTER V

PROFIT

IF all occupations compete in the labour market, then among them must be the occupations of producer and dealer, of which we have already had something to say. In what way and to what extent are the gains derived by these classes from their business affected by the equalizing power of the market ?

One characteristic of the producers and dealers is that they *possess* the material objects which are used in their business —that is to say, capital. Possession may be the result of absolute ownership or of hiring, and ownership itself may be unencumbered, or may be acquired partly by borrowed money. These are matters to which we shall turn our attention when we come to the capital market.

The class of people who possess or who can acquire material resources in any considerable quantity is limited, and the dealers and producers must be recruited within the limits of this class. Here at the outset there is a barrier shutting them off from the rest of the labour market.

We will consider the case of the dealers first. The material objects possessed by a dealer for the purposes of his business are bought and sold by him in the commodity markets. His income arises from the difference between the price at which he buys and the price at which he sells, and is therefore the joint product of this difference and his "turn-over." It is his interest that the difference be as great as possible, and, on the other hand, it is also his interest that the volume of transactions, on which he profits by the difference, be as great as possible.

At first sight the position of the dealers in any commodity would seem to be extremely unstable. Cannot any one of them at any time get business away from the others by offering either to buy at a slightly higher price, or to sell at a slightly lower ? What he would lose in price difference he might more than gain in volume of transactions.

In some markets, particularly those in which some of the great staple raw materials of the world are dealt in, minute adaptations of price to the state of the market, as judged by every individual dealer, are the rule. The quotation of a price at any moment of the day attracts those buyers who expect a rise and those sellers who expect a fall. A momentary excess of buyers or of sellers will cause the next quotation to be slightly higher or slightly lower as the case may be.

Buyers and sellers are guided by their opinions as to all the influences likely to affect either demand or supply in the future, and their success depends on the correctness of their opinions. To buy above or sell below the predominant price (except on the ground of better information) is to court losses.

But even in a highly organized market of this type, convention secures the dealers a regular profit over and above the speculative profits accruing from their special knowledge and good judgment. It is probably a part of the constitution of the market that only those who are definitely accepted as regular professional dealers in the market are allowed to quote a price at all, and the price quoted to outsiders will be a double price, a higher limit if the outsider wants to buy and a lower if he wants to sell. The difference between the buying and selling prices (called the " turn of the market ") is not necessarily a fixed amount, and it may be very small, but whatever the practice may be, the turn represents a remuneration secured to the professional dealers as such, and maintained ultimately by the limitation of their membership.

In such a market as this, the distinction between professional dealers and the outside world, and the privileges accorded to them are made, either by law or by custom, a matter of rule. But in the more general case, where a market is not so formally constituted, and prices are not so sensitive, there tends to be a tacit understanding among dealers to respect one another's profits. A " balance of power " is preserved, and any one who disturbs it by a campaign of price-cutting is a common enemy. If he succeeds, the other dealers will all suffer ; if he fails, all the disturbance, with the trouble and anxiety and loss caused to the dealers, will have been to no purpose.

In such a market dealers will try to keep prices unchanged for considerable periods of time, even though there may be quite perceptible changes in supply and demand. They may go on selling at a uniform price, even though they are

buying in a sensitive market, where the prices are rarely the same for two days together, or though their sales are noticeably rising or falling. When the circumstances make a change of price desirable, they will all make the same change at the same time, either by agreement or by following the lead of a few.

Conventional prices mean conventional profits. In the absence of a chartered market, from which all but its own members are excluded, how are conventional profits to be protected against outside competition? Or will the labour market inevitably level down the dealers' incomes to those earned in careers demanding no greater skill and training?

We have already mentioned that a dealer's income is a function not of his rate of profit solely, but jointly of his profit and the volume of his business. The labour market can only affect the incomes earned by the dealers through the competition of the newcomers that may be attracted to the business from other callings. These newcomers will be attracted by a comparison of the profits they can hope to get with the incomes to be obtained elsewhere. Their expectations will be governed not only by the rate of profit, but by the amount of business they are likely to secure. If the rate of profit seems abnormally high, they will hope perhaps to gain business by price-cutting. But then, to gain much business, they must risk much capital. There is, it is true, a certain elasticity in the relation of business to capital. A man, who goes into business with a moderate amount of capital, and who successfully gains business by price-cutting, will sell off his stock quickly and replenish it quickly. But, even so, some relation must be preserved between the volume of business and the amount of capital.

But a more serious limitation on the extension of the newcomer's business is to be found in the special knowledge required. This special knowledge is of two kinds: knowledge of the commodities dealt in, and knowledge of the people dealt with. Both kinds of knowledge are to be obtained chiefly by experience, and experience can only be obtained by risking capital. There is no system of apprenticeship in this calling. An aspirant may gain access to the magic ring through a relation or a friend, or possibly an employer, who will take him into partnership in a business already established. Otherwise he can only buy the requisite training at the cost of risking the loss of his capital.

This is a severe condition to face, and in practice the new-

comer would hardly venture to operate in a market unless he had already made a beginning in gaining the requisite knowledge.

This itself is a narrow limitation upon potential competition. But in any case his knowledge can only be partial, till he has had some direct experience of dealing. Scientific study, or experience of other closely related markets may have given him a very good knowledge of the commodities But in the market he will need to know very precisely what qualities in the commodities the buyers need and the producers can supply.

Here knowledge of the commodities is merged in knowledge of the individuals. It is not only knowledge of their requirements that is needed, but knowledge of their habits and knowledge of their characters, especially, for example, in the matter of probity. And correlative with the dealers' knowledge of their customers, is the customers' knowledge of the dealers. Each is accustomed to transact business with a particular dealer or set of dealers. The newcomer is faced with the problem of inducing them to abandon those dealers, and to transact business with him. The inducement he has to offer is a more favourable price, but how will that price look to the customers he hopes to draw away? To leave those dealers whom they know, and who know their habits and requirements, is to run a risk. Price is not everything, even from the point of view of direct pecuniary gain and loss. The real merits and demerits of the new dealer can only be tested by experience, and that experience can only be gained at the cost of severing the old ties. If the experience turns out to be unfavourable, it may be difficult to restore the pre-existing connexions.

But it is not to be lightly assumed even that the newcomer will be able to offer a more favourable price. The existing dealers cannot stand by and see him outbid them. Such an inequality of prices is the negation of a market. At whatever sacrifice of profit, they must forthwith adjust their prices to his. So he will start with no advantage at all, and might just as well accept the pre-existing standards of prices and profits.

In fact the intruder is not likely to get a start at all unless, besides possessing the necessary equipment of capital, he has some special qualification for the market. For example, he may enter as the champion of some new invention, a new pattern or a new process, or he may be one of the customers of the market, who has acquired something of the necessary experience. By such means he may be enabled to cross the

barrier, but even so, as a rule, his prospect of profit will be no more than in proportion to his capital.

The case where he has a large capital is exceptional. A commercial attack on a grand scale is a rare event, and is probably accompanied by a variety of manœuvres, assaults and flank attacks, among which price-cutting, if it figures at all, is only one. Where the newcomer is a middling capitalist, he cannot expect to get more than a middling business. If the prevalent rate of profit is not more than will secure such a one the same income as in the ordinary run of alternative occupations, the trade is adequately secured against profit-cutting by competition from outside. But at the same time those inside may be getting far larger incomes than a newcomer could hope for. Once established, a dealer can set to work to strengthen his business. So palpable a competitive act as price-cutting may be ruled out as inconsistent with the balance of power of the market, but dealers will be free to compete with one another in activity, knowledge of the business, and foresight, in the facilities and conveniences they can offer to their customers. One will be especially skilful in grading the materials that he deals in, another can always be relied on to have whatever his customers require ready in stock, another will give special attention to efficient packing, another will be able to give long credit. Some will get the advantage of others in these and other ways, and as the business of any dealer grows in volume, the better equipped will he be to improve the facilities he offers. In commerce it is especially true that to him that hath shall be given. And he that hath not will sooner or later go into the bankruptcy court, or be amalgamated with him that hath.

Thus the competition of the labour market is not inconsistent with the existence of disproportionately big incomes in commerce A numerical example will illustrate the point further. It may be that a man with £2,500 of capital can expect to make £1,000 a year as a dealer in a certain commodity market. But he cannot hope to do this unless he possesses certain abilities and attainments, and it may be that so equipped he could earn £1,000 a year in a profession without risking any capital at all. Commercial business is not in itself likely to be more congenial than a professional occupation, and in the circumstances the man would choose the latter. Only those with equal qualifications and a substantially higher capital would be attracted in, and it may well be that the competition so limited would not be sufficient to threaten the rate of profit.

Turn now to the dealers established in the market. The man with £50,000 of capital may be making £20,000 a year. Very likely he will be making substantially more, because he can afford to engage highly skilled salaried assistants, and to pay for an extensive service of information. In virtue of his larger turnover, he will be in touch with a greater number of producers on the one side and of retailers on the other, and will be better situated to choose his opportunities for both buying and selling. To the regular rate of profit he will be able to add a considerable speculative profit by using these advantages.

Now a man with £50,000 of capital will certainly not spend the whole of an income of £20,000 a year; he will think it prudent to save a considerable part of what he earns. So his capital will grow, and he will get a growing share of whatever new business offers.

Thus the wholesale commodity markets tend to be in the hands of a limited number of big dealers, protected in the manner described against the competition of outsiders.

The share of each dealer in the business of the market depends partly on the amount of his capital, but still more on the people accustomed to deal with him. That does not mean that those who buy from the market or sell to it will confine themselves each to the services of one dealer. But each will usually transact business only with a limited circle of dealers, each of whom will receive a fairly steady share of his custom. Everyone concerned will tend, in the absence of any reason to the contrary, to follow his established routine, and to deal in the ways he knows with the people he knows. This continuity in dealings creates what is called business connexion or "goodwill." It is the very stuff and substance of the dealer's business. The principal deterrent upon intruders into the market is that they have to create their goodwill from the beginning. The distinguishing characteristic of the successful merchant is the extent and solidity of his goodwill.

The dealer's capital imposes an upper limit on his goodwill. If he secures a greater volume of business than his resources will enable him to finance, he will perforce have to abandon some of it. On the other hand the possession of a certain amount of capital is no guarantee that a proportional amount of business will be obtained. The dealer's goodwill is built up by his own efforts, skill and good fortune.

Every dealer normally seeks to expand his business. If only he can extend his goodwill, he can usually find some

means of increasing his capital, not only by the slow process of saving, but by bringing in new partners or shareholders, and in any case there is a certain elasticity about the amount he can borrow from his banker. Dealers spend lavishly on anything that will extend their goodwill, especially on advertising.

The result of success is an increased turnover and an income big in proportion, an income which may be far above the standards of remuneration for corresponding skill and effort in the labour market.

We reach the very important conclusion that the equalizing effect of the market does apply to profit, but it is not the incomes of the traders that are equalized ; it is the ratio of profit to the value of the goods bought and sold. Even this equalization is very incomplete. The prevalent rates of profit differ materially in different trades, according to the circumstances, and particularly according to the amount of capital required for a given turnover.

We have been speaking of the dealers in a single commodity market as if they were a rigidly self-contained group. But in practice that is not so. Every dealer in commodities finds opportunities to extend his business into allied trades. Both those from whom he buys and those to whom he sells are likely to buy and sell other commodities besides those in which he started to deal. He must study the markets in these other commodities, because the prospects of the different markets will be to some extent interdependent. And starting with his acquaintance with the personnel of these markets, he can enter into them not as an outsider but as an established dealer ready equipped.

A dealer's capital is all or nearly all *circulating* capital. It consists of a stock of commodities which he is continually selling off and replenishing. He can at any time transform this stock from one kind of commodity to another, if he expects the change to be profitable. He can increase his stock by buying more with borrowed money, or he can diminish it by replacing less than he sells off, and keeping part of his capital in money.

If we turn from the merchant or wholesale dealer to the retail dealer, we find a somewhat different condition in regard to goodwill. The retail dealer is equally dependent upon his goodwill, but his position is more secure, because his customers' habits are governed to some extent by local convenience. It is only in particular cases that this local convenience is decisive ; more usually there are several retail dealers in such close proximity that the localities they

supply are practically identical. But even among them competition is limited by local conditions, and the goodwill of all *taken in the aggregate* is not threatened by their more distant competitors. Improvements in the internal communications of great cities have facilitated the development of big central shops, drawing customers from a large population, but still those with a more local and circumscribed goodwill remain.

Concentration of business and of capital in a few hands does not occur so readily in retail dealing as in wholesale dealing. To the wholesale dealer with an established connexion little more work is involved in buying and selling 10,000 bales of cotton than 100. But the retail dealer only sells in such amounts as the consumers choose to buy, and the sales from any one shop are limited by its local goodwill. One man or company may own many shops, but such multiple ownership is by no means entirely advantageous. It secures little or no economy in the actual work of salesmanship, and it loses the advantage in supervision possessed by the man whose activities are confined to a single shop. In a big central shop, where conditions favour it, there are real economies, but they are not so great in proportion as in the case of manufacture on a large scale. And in any case its customers are limited to those to whom central shopping is convenient, and it can only cover a very limited portion of the entire field of retail dealing.

Retail dealers buy from wholesale dealers, and upon their demand depends the goodwill of the latter. Wholesale dealers tend to do business on a bigger scale than retail dealers, and, being richer and more powerful, may find it advantageous to entrench their goodwill by buying up or establishing shops on their own account. In some trades it is common for the entire process of distribution to be kept in the hands of the manufacturer of the finished product. For example brewers in England acquire public-houses. Boot and shoe manufacturers often own shops in which their products are sold.

Where the functions of dealer and producer are merged, it is usually the interests of the former that predominate. It is by dealing that the biggest profits are made, and upon successful dealing the outlet for the product depends.

And here we must turn to consider the position of the producer. Producers resemble dealers in that their remuneration takes the form of profit. They buy in the labour market and in the markets for raw materials, and then sell

in the markets for their finished products. They depend, like the dealers, for their incomes upon the difference between buying and selling price. But in one respect their position is profoundly different. Their business necessitates the use of a substantial amount of *fixed* capital. A producer's resources once spent on plant or other forms of fixed capital, he cannot afford to leave this capital idle, nor can he change over to another form of production, unless he can sell his existing business to someone else, who will only buy it with a view to carrying on the production for which it is fitted In creating this fixed capital he has given a hostage to fortune, and he has not the freedom enjoyed by a dealer.

Apart from the earning of interest, plant is a direct source of expense for maintenance, and also for depreciation. That is to say, prudence requires that provision should be regularly made with a view to its renewal when it is past use. The practice is to make a payment year by year into what is called a depreciation fund, the annual payments being so calculated that, by the time the plant is worn out or obsolete, they will have accumulated to a sufficient sum to meet the cost of replacement. Besides these charges, the owner of productive plant usually cannot avoid keeping together a certain minimum organization of supervising staff, however little work may be in progress, and he is probably unwilling to disperse the skilled workmen whom he usually employs.

Thus there is a heavy deadweight annual expense, commonly called the overhead charges, to be covered before the concern yields him any income. The only source from which this expense can be met is the profit on the product, the difference between the price at which it is sold and the outlay on wages and materials.

People will not embark capital in the production of any commodity unless they see their way to make a clear profit. If the conditions of the market are sufficiently steady to be foreseen, and the amount of the productive resources put into the industry is properly proportioned to demand, then, when output is at the average level, the receipts in each concern should be sufficient, after making good the direct costs of wages and materials, to pay all the overhead charges, and leave a reasonable profit in addition.

But when for any reason output falls below the average, or when the price of the product falls relatively to cost, the profit may fade away, and some or all of the businesses may

be conducted at an actual loss. So long as the production carried on yields some return in excess of direct costs, it is worth while to go on producing, for, even if this return is so low that it does not cover the overhead charges, it at any rate diminishes the loss in respect of them.

On the other hand, when output rises above the average, the profits are increased. But the productive capacity of the entire resources of the industry is limited. Some elasticity can be given to the limit by resorting to overtime or additional shifts, but still there is a limit, which can only be definitely extended by the entry of fresh capital and fresh labour into the industry.

It is the interest of the producer to keep his output as near as possible to the normal. His need to do this puts him at a disadvantage in comparison with the dealer, who has no such ties. At the same time the producer has the benefit of a certain stability, which the dealer has not. So long as the market is taking a supply of the product equal to the normal output or not far short of it, this supply must be obtained from the producers who are already equipped with the necessary plant and workmen. They will have no rivals unless there is good reason to suppose that the demand for the product, at a sufficiently high price to yield a good profit, will exceed the capacity of the existing producers. A newcomer must bring with him fixed as well as circulating capital, and when he has sunk his fixed capital in the venture he has committed himself to it, and cannot change again without a heavy loss.

It follows that though goodwill is of some importance to a producer, it is not so vital to him as to a dealer. Whenever demand approaches the capacity of the industry, a business engaged in it and adequately equipped will be fully employed, even though it be entirely without any pre-existing trade connexion. Once so employed, it has made a beginning in creating, or, it may be, in reviving a trade connexion.

In an industry that is over-capitalized in proportion to demand that is not so. If the industry is always under-employed each separate concern will depend very much on its goodwill. But, as in the case of the less successful dealers in a market, the less successful producers will probably sooner or later come to grief, and their plant will be scrapped, till the total capacity of the industry is brought back to the proper relation to demand.

The characteristic of both producers and dealers is the possession of the material objects used in their business.

Whoever would qualify for entrance into these careers must have the requisite material possessions.

Material possessions may be acquired by transmission (that is to say, by inheritance, bequest or gift) from a previous possessor, or by accumulation. Anyone is free to consume as much or as little as he pleases out of his income, once his essential needs are satisfied. When he leaves a part unconsumed, what has he to show for it?

Everyone possesses some kind of stock of personal or household goods; for example, current supplies of food and other consumable products, and a greater or less quantity of more durable possessions, clothes, furniture, books, utensils, ornaments. These things are acquired with a view to being enjoyed; nevertheless they are a form of accumulation.

A man who uses capital in his business may add to that capital. If he is a dealer, he may increase his stock of commodities. If he is a producer, he may extend his plant. By so doing his business will become so much the more valuable.

But suppose that he wants to add to his possessions, but that he has all the household goods he needs, and there is no opening for putting capital into his business. Then, if he chooses, he can accumulate his unspent income in the form of money. So long as he holds money, he is free to turn it at any time into any form of wealth that the markets can offer.

But that by no means exhausts the possibilities. We have seen that entry into the privileged ranks of dealers and producers is limited to those who have capital, and that, if they are successful, the extent of their profits is proportional to the amount of their capital. One whose business is being restricted for want of capital will be eager to get more capital if he can. On the other hand, to some people who possess capital, the career of a dealer or producer is not open, either because they are already engaged in some satisfactory calling which does not require capital, or because the amount of their capital is not big enough, or because they have not the temperament or experience suitable for trade, or for any other reason. If a man in such a position places his capital at the disposition of another who is a trader,[1] he may enable the latter to extend his business and therefore his profits. It will be worth while

[1] The term "trader" may conveniently be used to include both producers and dealers.

for the trader to offer the other some inducement to make such an arrangement.

The form and extent of the inducement are determined, in the same way as the terms of any other exchange, by competition in a market. This is the capital market, which will form the subject of the next chapter.

CHAPTER VI

THE CAPITAL MARKET

WE saw at the end of the last chapter that people who do not need capital for the occupations in which they are themselves engaged may accumulate surplus resources, and that it will be worth the while of one who uses capital in his business to induce them to make these surplus resources available for the extension of his capital, that is to say, to *invest* in his business.

The bargain between the investor and the trader is in several respects more complex than the ordinary purchase and sale in a commodity market. The trader receives the investor's savings in the form of money and he spends the money on whatever form of capital it may be that his business needs. But the investor does not in general become the *owner* of the physical objects in which this extension of capital is embodied. The value of these objects depends on their being used for the purposes of the business, and for this the investor has to rely upon the trader. The bargain between the investor and the trader is a *pecuniary* one. The investor, having parted with his money, will expect to have rights as against the trader, which are the equivalent of the money. These rights may take either of two forms. The investor may become the *creditor* of the trader for the sum invested, or he may become in some degree a *partner* in the trader's business If he becomes a full working partner, he becomes himself a trader. That is not the case we are considering. The investor may, however, undertake some of the risks of a partner, without assuming any appreciable share of the work of managing the business. That is the position of the shareholder, who remains a mere investor, though he is part-owner of the business. A business carried on as a company with share capital is nominally governed by the shareholders, but as a general rule that constitution is chosen expressly in order that the share-

holders may be able to delegate all the real work and substantially all the responsibility to the directors.[1] The shareholder, in return for the money he invests, receives the right to a share of the profits of the business. He cannot expect to get as high a proportionate share as one who has not only contributed capital but also takes an active part in the conduct of the business. The latter will be both a shareholder and a director, and will receive a salary in the latter capacity. But the salary is by no means the whole of the difference in the remuneration received by them. There must be some person or body of persons by whom the business is *started.* It may have begun on a smaller scale, and have been extended at a later stage by the creation of share capital, or it may have been launched fully constituted as a company, by a set of promoters. But even in the latter alternative the promoters must have had some sort of footing in the business before they appealed to the investor. Whatever the history of the business may be, those who started it will be in a position to claim a larger share of the profits than those who entered as mere investors. This is usually done by making the company pay for "goodwill" or "promotion expenses" as part of its capital equipment. The promoters are credited with a certain holding of shares in consideration of their having launched the business, and receive dividends on these shares, as well as on those representing any contribution they have made to its physical capital. Very similar arrangements can be made within the limits of a private partnership, the active partners being allowed a share of profits more than in proportion to the capital they have put into the common stock.

In the case where the investor becomes not a partner but a creditor of the trader, the question arises of *security* for the debt so created. The investor might be content to let the debt remain unsecured, as a purely personal obligation of the trader. But, if so, he must rely not only on the honesty but on the prudence of the trader. More often he will insist on security, and the nature both of the debt and of the security will depend on the character of the business. The circulating capital of a merchant or dealer, consists of goods which he buys to sell again, and which are therefore perpetually changing. If the goods themselves are to be used as security for the money borrowed by him, any partic-

[1] In virtue of their power of choosing the directors, the shareholders can, if they choose, *control* the business. To shareholders who know how to use it, this power of control may be more valuable than dividends.

ular consignment can only be so used for the short time it is in his hands. Partly for this reason, and partly to avoid borrowing more at any one time than they really need, it is the usual practice of merchants to borrow for short periods, not exceeding a few months. The ordinary investor does not want to lend his money for a short period, and to have the trouble of perpetually reinvesting it. But there is a special class of investor to whom the repayment of his money at short intervals is a positive advantage. That is the banker, and his position is so different from that of other investors that we shall deal separately with the subject of short-term borrowing, and confine ourselves in the present chapter to the case of long-term investment.

The investor who wants to lend his money to a business, and leave it there for a long period adequately and continuously secured, can find what he seeks in those extensive branches of production or of transport, which under modern conditions require a heavy outlay on fixed capital. As we saw in the last chapter, this kind of business is less dependent upon goodwill, and therefore less precarious, than that of the merchant. There tends to be a certain adjustment of the aggregate amount of fixed capital engaged in any productive industry to the permanent or average demand for the product. So long as the adjustment is preserved, each individual business that possesses a part of the fixed capital may expect to get an appropriate share of the work to be done, and its fixed capital possesses a corresponding value. Even when too much fixed capital intrudes into the industry, and all cannot be always regularly employed, it will still be only the less efficient businesses that suffer seriously from intermittency of employment. Thus in general the fixed capital of a normally efficient business has an earning power and therefore a value not altogether dependent on goodwill, and to that extent affords suitable security for a debt.[1]

It is obvious that the investor will not be satisfied to lend his money for a long period, even if repayment is adequately secured, unless he gets something for doing so in addition to the mere repayment of the sum lent. It is not merely that he might have kept the money in his own hands, without the risk (that cannot be completely eliminated) of the trader defaulting and the security failing, but the trader, if success-

[1] Even when a business fails and is wound up, so that the earning power of its fixed capital for the original purpose vanishes, the capital assets can often still be adapted for other purposes, and sold (at some sacrifice of value) for the benefit of the secured creditors.

ful, is all the time making a profit out of the additional capital, and is therefore in a position to pay something for the use of it.

In the capital market we find a variety of opportunities offered to the investor. All are in competition with one another. He can choose on the one hand to be a secured creditor, a mortgagee or debenture holder, or on the other to be a partner or shareholder. This variety proceeds of course from the traders or promoters who raise the capital. They offer shares, debentures, or other types of investment to suit their own requirements and those of the investors.

We are considering here investments of the *permanent* class ; that is to say, the investor either gives up all right to receive back the capital sum invested, except in the event of the liquidation of the business, or he agrees to leave it outstanding for a considerable period of years, or if, as in the case of a mortgage, he retains the right to demand repayment of his money on giving an agreed notice, he still intends to leave his money undisturbed for a long time. So long as it lasts, the investment will be a source of profit to the business in which it is placed, and the inducement to the investor is in some form a share of this profit. The share of profit will in general be paid in money, and the market will tend to *equalize* the yield of the same capital sum invested for the same period under the same conditions, just as the commodity market tends to equalize prices. Where the investor becomes a shareholder, the yield depends upon the prospects of the business, and those prospects must enter into the investor's calculations when he chooses the investment. But where the investor becomes a debenture-holder, he bargains for a fixed yearly sum of money, which will be expressed as so much per cent. of the sum invested. The offer of so much per cent. per annum in return for the investment of a capital sum may be regarded as the characteristic type of the bargains of the investment market. Where shares are purchased, the investor compares the yield he expects with the fixed yield that he might obtain from debentures or other fixed-interest-yielding investments. But, even where the yield is at a fixed rate per cent., the attractiveness of the investment is affected by such considerations as the security for payment, and there will be corresponding inequalities in the rate of yield.

The field of the capital market is not limited to investments in industry, trade and transportation. There are a variety of other opportunities for obtaining an annual in

exchange for a capital sum. For example the capital sum may be laid out on the erection of dwelling houses from which the investor will receive the rents. There will be a market for the letting of houses, which will be in competition with other branches of the investment market, and the yield derived from rents will always tend to approximate to that derived from investment in business. The rents which people are prepared to pay for houses will depend upon the supply of houses. If the supply of new houses is not maintained, rents will rise, and the investment of capital in house building will become relatively more attractive. If too many new houses are built, rents will fall, and such investments will become relatively less attractive. But here, as in the case of the purchase of shares, the yield of the investment cannot be exactly foretold, and it is the investor's *expectation* of yield which constitutes his inducement.

If the capital market tends to establish a uniform annual yield (subject to the necessary corrections) from the investment of a given capital sum, what will this yield tend to be? The supply of money for investment emanates from those people who refrain from spending the whole of their incomes as received, and who wish to derive gain from the surplus while it remains unspent. In a community where there is social security, and where the practice of investment is developed, nearly all the people who have a surplus of any considerable amount will invest all beyond a moderate working balance of money. The amount of the surplus they decide to leave unspent will not usually be very much affected by the amount of the yield anticipated from investment. People save from motives of prudence. Either they save moderate sums to provide against illness, or loss of employment, or old age, or, if they have the opportunity, they try to amass fortunes big enough to yield an income on which they and their children can live in independence. A high yield will not necessarily strengthen the motives for saving. Indeed, as has often been pointed out, a high yield, providing a given income from a smaller capital sum, may actually satisfy these motives with a smaller amount of saving. A man who wants to secure his widow £200 a year in case of his death will insure his life for £5,000 if the rate of interest is 4 per cent. If the rate is 5 per cent., £4,000 will suffice, and on this lower sum he will pay a lower rate of premium per cent.

It is rather the *demand* for investible savings than the supply that is affected by the market rate of interest or yield on investments. The working of the market can best be

studied in the case of debentures or fixed-interest-bearing securities. For example, a manufacturer is considering an improvement of his plant, which is to be provided by an issue of debentures. On what terms will he be willing to issue them? His capital consists of buildings and plant and other material objects, by which his employees are assisted in the process of production. Some capital of this kind there must in any case be, and under modern conditions, in most industries, the amount required is considerable. But the amount and kind of plant required for a given business are not absolutely fixed. When all the essential plant has been installed, it will still be possible to add to it various improvements, involving outlay, from which advantage will be reaped in the form either of a saving of labour and other costs or of an increased output with a given expenditure of labour. The advantage can be expressed as a yield of so much money, and therefore as so much per cent. per annum, upon the money cost of the improvement from which it is derived. When the manufacturer borrows for a capital outlay of this kind, he will certainly not be willing to pay a rate of interest higher than the yield of the capital so calculated. Thus, with a given rate of interest in the investment market, the amount of capital expenditure which each producer will tend to put into his business will be sufficient and no more than sufficient, to install all the plant and labour-saving arrangements of which the yield is not less than that rate. A lowering of the rate will therefore give an inducement to all the producers to effect improvements in their capital, and will thus evoke a new and additional demand for investible funds. A raising of the rate will rule out as unprofitable some improvements that would otherwise have been undertaken

Besides improvements in existing plant, capital expenditure is also needed, at any rate in a growing community, for the establishment of new productive enterprises, in order to provide an increased output of commodities. In these new enterprises the amount of capital outlay required will be affected by the rate of interest in the same way as the extent of the improvements to be made in existing enterprises. That is to say, the promoter will only install such plant or material aids to production as may be expected to yield at least the market rate of interest on their prime cost.

Obviously the greater part of the plant installed will be of a kind to yield more than this rate, and some will be so essential that it will yield many times as much, in the sense

that without it the output with a given amount of labour would be enormously reduced. But as everyone who starts business is free to supply himself with this essential plant, the benefit of its productive power is reflected not in the yield to the investor, or in the profit of the producer, but in the selling price of the product. Competition among producers keeps down this price to the level at which it yields (apart from profit) no more than the prevalent rate of interest on the capital invested, alike in the most essential plant, and in that which barely pays for itself.

The motive for extending the capital engaged in the production of a commodity is an expectation that the demand for the commodity at the existing price will outstrip the existing sources of supply. Unless the sources of supply are extended, there will be a rise of price. If there is a rise in the rate of interest, the new enterprises established will need to receive an increased price for the product in order to cover the increased interest charge, and the entry of new capital into the industry will be checked till the relative shortage of supply has led to a sufficient rise of price. On the other hand, a fall in the rate of interest will hasten the entry of new capital till the increase in output has brought about a corresponding fall of price.

The difference in price corresponding to a change in the rate of interest is likely to be very minute, and in practice the calculations of interest charges and of price cannot be made with a high degree of precision. In proportion as the calculations of those who enter into the investment market to raise fresh capital are inexact, their demands are the less sensitive to changes in the rate of interest. The market itself has to be all the more sensitive on that account. That is to say, a change either in the supply of savings or in the demand for investible funds may require a relatively large change in the rate of interest to restore equilibrium.

It is essential that the distinction between profits and interest be kept clear. Interest, being the payment for the use of capital, is proportional to the amount of capital used ; profit, being the difference between two market prices or between costs and selling price, is proportional to the total quantity of products bought and sold, or produced and sold, Interest figures, along with wages, salaries, rent, expenditure on materials, etc., as a part of the costs.

It is when the trader who uses the capital owns it that the distinction tends to be lost, for then there is no specific

payment of interest recorded in the costs. This is particularly true of the shareholder in a public company. Often he takes no part in the management of the company, but is simply an investor to whom the dividends he receives practically take the place of interest. In consideration of the risk of the dividend varying, he expects to get something more on the average than the equivalent of the normal market rate of interest on his capital, but that is a small difference and sufficiently explained.

But, for all that, the distinction between profits and interest should be insisted on in this case as much as in others. When the shares of well-known companies are dealt in in the investment market, what is bought and sold is the right to a share in the profits of the company. These are profits in the strict sense, depending upon the volume of business done by the company. If the company is a well established one, and its future profits can be estimated with a fair degree of approximation, they are taken into account in the price paid for the shares; the price includes an element of *capitalized goodwill*. If the circumstances of the company and the markets in which it deals are not subject to much change over a long period of time, this steadiness will show itself in the profits, and also in the price of the shares. The relation of profit to turnover still remains.

But is there not, it may be asked, a relation between the volume of business done and the amount of capital employed? There certainly is such a relation, but it is different for different industries. In some, especially in commerce, the proportion of capital to turnover is small. The merchant's capital is little more than his stock-in-trade, and if it is turned over quickly the amount on hand at any one time is proportionately less. Many forms of production are lightly capitalized and approximate to the commercial type.

The more heavily capitalized industries vary widely among themselves. As a rule under modern conditions the biggest capital in proportion to turnover is found in railways.

In all these different forms of business interest on capital has to be provided for as an expense, and the profit remaining is determined in the manner described in Chapter V. And even within the limits of a single industry the variation of profits with turnover frequently swamps the relation of interest to capital. It is only when conditions are stable that the relation of output to capital becomes steady, and the yield of capital can be distinguished. Even in a heavily

capitalized industry, a concern is often working below capacity—in fact it hardly ever gets near its absolute maximum capacity. It is therefore commonly in the position of meeting a fixed interest charge out of a variable profit

The essential function of the capital market is to equalize the demand and supply of investible funds. Incidentally it also offers facilities for investors to change from one investment to another. Anyone who has invested money in shares, debentures or similar "marketable" securities, can sell these investments in the market for a capital sum, and anyone who has money to invest, instead of being confined in his choice to the new capital issues that happen to be brought out at the time, can buy similar securities from the market. The dealers of the investment market keep a selection of securities on hand, from which they can satisfy the needs of investors, and which they keep replenished with the securities that they are called upon to buy. The securities they hold are their stock in trade, just like the stocks of goods held by dealers in the commodity markets.

When a man sells any of his investments, it is often for the purpose of reinvesting the proceeds in some other securities. Sometimes it is because he needs money to spend. In the former case the resources of the investment market are not affected, but in the latter the supply of investible funds is to that extent used up, and what is available to meet the needs of industry and trade is reduced. The funds received in the capital market for investment are the net amount left after deducting the proceeds of investments sold and applied otherwise than to reinvestment. This net amount must in the long run be equal to the new capital issues absorbed by the market. Any discrepancy between the capital issues and the net investible funds must appear in the form of a change in the investment market's holding of securities. The investment market cannot acquiesce any better than the commodity markets in a permanent divergence of its stock in trade from the normal. When investible funds fall short of new issues, the market's holding of securities is increased. Dealers then try to discourage promoters and to encourage investors by quoting lower prices of securities, or in other words increasing the yield upon a given capital sum.

As was pointed out above, the expectation of profit, on the strength of which a capital enterprise is promoted, is not likely to be so exact as to be materially affected by a small

change in the rate of interest. Nevertheless the fluctuations in the prices of securities, which constantly arise from the equalizing function of the market, introduce a conspicuously speculative element into the business of capital issues. The promoter who thinks it worth while to borrow at 5 per cent. can probably only make a very rough estimate of the probable profits, and, if he has to sell his 5 per cent. securities at, say, 98 instead of par, the likelihood of the interest charge being covered is not really very much diminished; but if he regards the drop to 98 as a temporary disturbance, and thinks that by waiting he can issue the securities at par after all, he will wait. It follows therefore that, whenever there is a general fall in the prices of securities, and the fall is recognized to be due to a temporary pressure on the market, there will be a postponement of new issues which will for the time being relieve the pressure.

And when a permanent change is made in the rate of interest, the new standard of yield will infallibly make itself felt in the new capital issues. However uncertain may be the estimates of yield which have to be brought to the test of this standard, the law of averages will ultimately ensure a close correspondence between the standard and the yield of those which pass the test.

The standard will likewise apply to house property. When the yield of capital in industry and transport tends to rise, investible funds will be diverted from house-building to the investment market. When the yield falls, house-building will be stimulated. Under certain conditions house-building might be so much more important as an object of investment than the equipment of industry and transport, that house rent would govern the rate of interest.

The investment market has done its work when it has received the investor's money and placed it at the disposal of the promoter. To complete the process of investment however, the promoter must *spend* the money on the construction of the fixed capital for which it is destined. The construction work is in general a business quite distinct from that which is to use the fixed capital when completed, and accordingly the promoter will employ a contractor to undertake it. The construction of fixed capital is something outside the scope of the commodity markets. That is so, not only because the unit dealt in is often far too big to be made the subject of market bargaining, but because the requirements of a business for fixed capital are usually so individual that the construction must be expressly designed

for it. The specification emanates from the consumer, that is to say, from the promoter of the capital enterprise.

An approximation to the working of a market can be secured by the tender system. The promoter asks several contractors each to name the price at which he will do the work. The expenses of the contractors for labour and materials are governed by the labour market and the commodity markets. The price named depends partly upon the contractor's efficiency in organizing his business, partly upon the profit he chooses to allow for himself, partly upon his vagaries in estimating, but partly also upon the prices he expects his competitors to ask. Under these conditions something of the equalizing influence of a market is felt, but the divergences in contractors' prices are for all that sometimes enormous.

The promoter, other things being equal, will accept the lowest tender. But the question is not solely one of price. That which he is buying from the contractor is something which will only come into existence in the future. If the work when finished is unsatisfactorily done, it is too late to replace it. The defects, if serious, may involve a heavy further expense, towards which it is unlikely that anything material can be recovered from the contractor, even if such default or negligence has occurred, as to involve him in any legal liability. Thus the efficiency of the contractor is a matter of paramount importance, and a contractor's reputation for efficiency is the foundation of his "goodwill."

Capital expenditure is not necessarily on a large scale. It includes a multitude of small building operations, the purchase, installation or adaptation of minor mechanical appliances, the purchase of vehicles, etc. Such outlays are often met out of income without being charged to capital account, or, if charged to capital account, without involving recourse to the investment market.

The organization of the investment market is more complex than that of a commodity market. That is partly because the market is always dealing in old securities as well as in new ones ; partly because the new securities come into existence in large blocks, the disposal of any one of which is a very serious and responsible affair ; partly because investment is so important a part of any man's expenditure that he exercises a more careful judgment and requires a more expert advice upon it than upon the purchase of commodities.

There is no reason in the nature of things why a dealer in the investment market should not undertake all its different operations, buying and selling both new and old securities.

But the business of issuing new securities has, especially in London, the greatest of all investment markets, gathered round itself a peculiar specialization of function.

Before explaining this specialization we must return to the other branch of the capital market, that is to say banking.

CHAPTER VII

FINANCE

UNDER modern economic conditions banking may be treated as a branch of the capital market, but it is something more. It has been pointed out above (p. 15) that a medium of exchange is necessary for the operations of the commodity markets, but that this medium of exchange need not necessarily be itself a valuable commodity. The sale of a commodity or a service creates a debt from the buyer to the seller. The debt, like the price of that which is sold, is expressed in a unit of value, and law or custom empowers the debtor to pay, and the creditor to require payment, in the recognized medium of exchange, money. But payment in money is by no means always the most convenient course either for the debtor or for the creditor. Where the debt is large (as it would usually be in the wholesale market) the handling, counting and safekeeping of the correspondingly large sums of money are a matter of considerable trouble and therefore expense.

Now people who receive incomes are continually becoming creditors for what they earn or acquire, and becoming debtors for what they spend. If any one had all these dealings exclusively with one other person, he could set off his debts and credits against one another, and could settle them (except for any change in the balance remaining from time to time unspent) without the use of money. The whole would be a matter simply of book keeping. As his creditors will not in practice be identical with his debtors, it is not possible to resort to a mutual cancellation of debts in this simple form. But where the law allows a creditor to assign away his rights in respect of a debt to someone else, it is possible to attain substantially the same result. If debtors and creditors agreed among themselves that all the creditors should assign their rights to one individual, he would become the debtor of all the creditors and at the same time the creditor of all the debtors. In his books of account the debts

and credits of each would be set off against one another leaving a net balance, which might be either a debit or a credit balance. As the gross aggregates of all the debts and of all the credits would be equal, the total of the debit balances would necessarily be equal to the total of the credit balances.

Here we have in its ultimate essence the function of the banker. He is, as it were, a dealer in debts, offering facilities to his customers to set off or "clear" their debts and credits,[1] without resorting to so clumsy an expedient as the use of a physical medium of exchange. For some transactions, particularly the smaller ones, this assignment of debts would give more trouble than it would save. Some of the creditors of the banker may have debts to pay in money, and they will accordingly want him to pay a part of his debts to them in money. At the same time others will be receiving payment of a part of the debts due to them in money, and they may pay the money to him in exchange for credits. The banker, like all debtors, is liable to pay his creditors in money. But as his creditors can assign away whatever balance he owes them, and thus use it as a medium of payment, the balance is the equivalent to them of actual money, and they are content to leave a balance outstanding indefinitely, upon which they can draw whenever they have payments to make. They only ask for payment in money when they have occasion themselves to use money to meet their own liabilities.

But what of the banker's debtors? If a man's debts exceed his credits, is he to be at liberty to remain as long as he pleases indebted to his banker? Where the banker is indebted to his customer, he provides the customer with a means of payment, and this is an inducement to the customer to let the debt continue, and the customer can, at his convenience, exact payment in money at any time. But if the customer is indebted to the banker, that is no advantage to the banker, and so the banker will require some inducement from the customer by way of consideration for the continuance of the debt. In other words the banker will treat the debt as an *investment*, and will require payment of interest upon it.

In what circumstances will people wish to borrow from a bank at the price of paying interest? In the artificially simplified hypothesis with which we started, debit balances

[1] The term "credit" is used in many senses, but here it is no more than a synonym for "debt." That which to the debtor is a *debt* is to the creditor a *credit*.

arose out of the settlement of liabilities among a group of people, and such balances would normally be purely transitory. If a man chooses to prolong his indebtedness to his banker, that will usually be because he wants to use additional capital in his business. A banker may make an investment in such a case of the ordinary permanent kind. But there are special circumstances in the business of banking, which make permanent or long-term investments inappropriate except on a restricted scale.

A banker assumes liabilities, which he may be called upon to pay *on demand*. That does not merely mean that he must pay out money for any of his depositors that may happen to need it. There are other circumstances in which he may have to pay. In any community there will naturally be several banks—perhaps many. The mutual liabilities of customers of one and the same bank can be settled in the books of that bank. But where the customers of one bank settle with the customers of another, there will in general be a net balance due one way or the other, and in special circumstances this balance may be considerable. To complete the settlement, the balance must be paid by the bank from whose customers it is due to the other bank. The process by which such inter-bank balances are settled is called "clearing"; where the banks are suitably organized, their agents meet together daily and set off the balances due to and from each bank, so that each only needs to make or receive a single net payment. This single net payment may have to be made in money, but, if there is a central bank, which acts as the banker of all the other banks, these latter can pay one another by drawing upon the balances they keep with the central bank.

But, with all these refinements, any bank must still be prepared, not only to meet its customers' cash requirements, but also, if occasion arise, to meet an adverse balance at the clearing house. If this adverse balance is considerable, it will deplete or may even exhaust the bank's holding of cash and its balance with the central bank, and, to guard against that contingency, every bank seeks to maintain a large part of its resources in a form which can be turned into cash at short notice.

We have already seen that merchants or dealers need to borrow for short periods, because their capital consists mainly of stocks of commodities which are perpetually changing. If a merchant had to possess enough resources of his own, or permanently invested with him, to cover the whole of his stock in trade, when at its maximum, he would

find himself, whenever his stock in trade fell appreciably below the maximum, with a corresponding amount of idle funds, which he could not invest, lest he should need them again for further purchases.

The lending of money to a merchant in this position is an ideal investment for a banker. The merchant proposes to buy a consignment of commodities, and will thereby become a debtor for their price. He has not a free credit balance to draw upon to pay the debt, but he can borrow from his banker for the purpose. That means that he becomes a debtor to his banker for the requisite sum, and his banker becomes a debtor to him for an identical amount. But the merchant's debt to the banker only falls due at an agreed future date (when the merchant expects to have the means of paying it) and the merchant has to pay interest for the interval; whereas the banker's debt to the merchant is immediately due, and the merchant can assign it away forthwith as a means of payment to the seller of the goods.

The banker may wish to be able to assign away the debts due to him in case he needs to raise money. He may require the merchant to give him a document, such as a promissory note, in which the title to the debt is embodied, and if, as is usually the case under modern legal systems, it is legally possible to assign the debt by merely transferring the document (presumably endorsed), the banker can sell it when he needs cash.

When the borrower comes direct to his banker in this way, what he seeks is not usually an advance to buy a particular identifiable consignment of goods, but a loan or overdraft to cover a temporary deficiency of cash arising from his business transactions as a whole. The greater part of the bank loans in the United States take this form, and are represented by promissory notes.

On the Continent of Europe a different procedure prevails. There banks lend money to trade chiefly through bills of exchange. A bill of exchange is a document by which a creditor (usually under an arrangement with the debtor) assigns his rights to someone else. For example, if one man has sold goods to another, and he wants to assign the purchaser's debt to his banker, he can write a document ordering the purchaser to pay the money to the banker. The vendor may want so to assign the debt, rather than to receive the sum due direct from the debtor, either because he has agreed that the debt shall fall due after an interval of time, or because the debtor carries on business at a distant place. In the former case the debt will be a suitable invest-

ment for the banker, and by selling it the creditor will get his money immediately (subject to the deduction of a suitable discount by way of interest). In the latter, the banker will make it his business, in virtue of his function of clearing debts, to settle with the debtor.

The use of bills of exchange is particularly convenient for the financing of sales between people at a distance, because the financing arrangements are then in the hands of the vendor, who has direct knowledge of the exact amount, character and value of the goods actually despatched, can draw and discount the bill at the very time that the goods start, and can attach to the bill as security the bills of lading, which give the discounting banker an actual title to the goods while in transit. These advantages, though they tend to lose importance as communications improve, remain nevertheless very great in foreign trade transactions, and even in domestic trade they still count for something.

In England bills are little used in internal trade, the prevalent practice being the grant by the banks of loans or overdrafts, unrepresented by any transferable document, but foreign trade takes so predominant a place in the English economic system, that London has the greatest of all markets in bills of exchange.

Whatever the form of short-term lending that may prevail, the banks that lend constitute a market. The organization of the market varies according to circumstances. The English banking system presents instructive examples of two totally different types of market. On the one hand there is a market for advances or overdrafts, in which lenders rarely bid directly against one another. The relation of a banker to his customer is a close one, and a change of banker involves many other consequences besides a change (if any) in the interest charged for overdrafts. In practice the tendency is for all the banks to make virtually the same charges for the same class of borrower. The rate of interest is fixed by all at, say, 1 or ½ per cent. above bank rate, with a minimum of 5 per cent.

In startling contrast is the great London discount market, or " money market." That market is formed not by banks but by a more specialized class of financial houses, the discount houses. The discount houses do not receive deposits, but their liabilities are loans at interest from the banks and some other lenders, repayable at short notice, and for the most part from day to day. Against these loans their assets are bills of exchange, which they make a practice of buying from all comers. In this business it is essential

to assess as justly as possible the credit of those whose names the bills bear, whether as acceptors, drawers, or endorsers (for all alike are guarantors). Subject to possible extra charges for names of inferior credit, the free play of the market fixes almost from hour to hour the rate of discount upon every kind of bill. To the dealers in the discount market every bill is simply a commodity. It is to this strictly impersonal attitude that the London discount market owes that freedom and fluidity for which it is celebrated, and which in recent years New York has in vain sought to imitate.

The short-term investments of banks are not limited to the financing of purchases of commodities. As we saw in the last chapter, the investment market, like the commodity markets, has its stock in trade, in the form of a supply of marketable investments, the volume of which fluctuates according to the state of the market. The dealers in investments, like the dealers in commodities, find it convenient to borrow money for short periods when their stock in trade increases, and to repay the loans when it diminishes. Dealings in investments are so large and frequent in proportion to the amount held in the market that it is usually found convenient to borrow for this purpose only for very short periods, even, as in the New York stock market, from day to day.

It is hardly necessary to say that there are many other purposes for which people, whether in business or not, may borrow from their bankers, if they can supply security, and can make suitable arrangements for repayment in a reasonable time.

But besides all these forms of short-term investment, banks also undertake a certain amount of long-term investment. The existence of the investment market makes it possible to sell long-term investment securities when cash is required, and, provided this can be done without loss, they will meet the requirements of a bank. But the market price of a long-term security varies within much wider limits than that of a debt falling due within a few months, and the investment market is apt to be sensitive to any unusual sales. The liabilities of a bank are fixed in terms of money, and, to ensure solvency, it needs assets of which the capital value is not liable to excessive depreciation.

The whole system of banking depends upon the solvency of the banks being specially safeguarded. If a debt due from a banker is to be accepted as a means of payment, it must be a good debt. To fulfil this condition, the assets held

against the banker's debts must be good, and, as there cannot be absolute safety from loss, there must be some margin or excess of total assets over total liabilities. In other words the banker must possess some resources in addition to those corresponding to his liabilities to his customers; he must have a *capital* of his own, like any other trader.

In investing his own capital, the banker need not confine his choice so narrowly. His position in this respect is not unlike that of a merchant. A merchant buys and sells commodities. A part of these commodities will be bought out of his own resources, but a part, and sometimes the greater part, will be bought with money borrowed from his banker, very likely by the discounting of bills. The bills can be secured, in part at any rate, upon the commodities bought with the proceeds. But the prices of commodities vary, and in an adverse market the commodities alone may not realize enough to cover the debt. The banker will require some margin over and above this security. The margin must be provided in some form out of the merchant's own capital. If the merchant has a large capital of his own, the banker may be satisfied to give him credit without any specific margin, or even without any specific security at all. The merchant's capital may be entirely outside his own business, being invested perhaps in securities, yielding him an income in addition to the profits of the business. These securities constitute a reserve or guarantee fund, ensuring that any losses incurred on the business will be made good, and the knowledge that such a fund exists justifies the banker in giving the merchant the accommodation required. If the merchant's business has been organized as a limited company, this reserve fund may appear in the balance sheet under the designations of "capital" and "reserve," the corresponding investments being put on the assets side. Alternatively the merchant, acting independently of the company, may give the banker his personal guarantee, thus engaging his private fortune in support of the company's credit.

The capital of a bank provides a guarantee fund very similar to the capital of a merchant. If it is not much larger than prudence requires for this purpose, it should be invested in marketable securities that can be sold in an emergency. But, as these securities are not married to a liability of fixed capital value, the risk of capital depreciation (combined of course with the possibility of appreciation) is not a serious drawback In fact so far as this part of his resources is

concerned, the banker has something of the freedom of the ordinary investor. He can use his skill and knowledge in choosing investments, even though he sometimes runs risks.

The greater his capital, the greater is his freedom in this respect. A bank with a capital large in proportion to its liabilities may enter big enterprises as a shareholder or promoter, although, until the success of the enterprises is proved by experience to the satisfaction of the investing public, it may be impossible to sell the interests so acquired in the investment market. Such investments are inappropriate and dangerous as assets to be held against a bank's liabilities to its customers. They ought therefore in the aggregate to be more than covered by the bank's capital and reserve.

A bank which thus has surplus resources available for investment is really an amalgamation of two distinct businesses, engaged respectively in the two branches of the capital market, a bank properly so-called dealing in short-term investments, and a financial house dealing in long-term investments. In England and America the two functions are usually distinct. In Europe they are often combined.

This brings us back to the question of the organization of the capital market at the point at which we left it at the end of the last chapter.

We saw in that chapter that the investment market has to equalize the supply of investible funds on the one hand with the new capital issues, which constitute the demand for such funds, on the other. We are now in a position to add that whenever this equalizing function is imperfectly discharged, and the investment market's holding of securities is increased or diminished, the market's indebtedness to the banks will be increased or diminished by an equal amount.[1] There is therefore a very intimate relation between the two branches of the capital market. Pressure or ease in either tends to be communicated to the other. Nor is there any hard and fast line between them. It is often doubtful, and therefore a matter of discretion, whether a particular operation should be financed by long-term or by short-term borrowing. A trader can choose according to his convenience which part of his business he shall carry on with his own capital and which part with borrowed money, and by his choice the character of the borrowing may be

[1] It may be pointed out that if the amount of securities held by the investment market not with borrowed money but with its own funds is increased or diminished, that is itself an increase or diminution in investible funds.

determined. Money is constantly being borrowed for short periods for the purpose of buying and holding investment securities by people who are not themselves professionally occupied in the investment market, and on the other hand money permanently invested in bank shares may be used for short-term lending.

Essentially then the capital market is *one*. But the actual machinery of the investment market is totally different from that of banking, even where it is very much in the hands of banks.

All long-term investment operations do not take place through the market. People will usually invest their savings in their own businesses so long as they find suitable openings there. It is only when their own businesses are sufficiently equipped with capital that they invest elsewhere.[1] Even then they do not necessarily come into the open market. For there is always a numerous class of borrowers seeking capital outside the market. In order that an investment security may be dealt in in the market, the total amount of the security in existence must be large. If it is to be well known, it must be important enough for the market to find the acquisition of knowledge about it worth while. And dealings in it must be fairly frequent ; otherwise the market price will have no significance. The market must hold, in the aggregate, a considerable supply of the security, so that any dealer who is asked to buy any reasonable amount of it can readily obtain it without having to go outside the market and offer a special inducement to private holders of the security to sell. And yet the market's holding of the security ought to be small in proportion to the total amount held by investors, for the market is no more than the channel through which securities are distributed to investors.

Thus the investment market is primarily concerned with very large issues. It can indeed be adapted to dispose of relatively small issues, which, when once in the hands of investors, need not subsequently be quoted. But in general he who wishes to raise a small amount of capital for his business must approach lenders by private negotiation. Loans of that kind, like investments in land, house property, etc., being, to the lenders, an alternative to an investment in a marketable security, are undoubtedly very much influenced by the yield offered to investors by the market.

[1] A man may indeed raise capital for his own business by borrowing, in order that he may have funds free for some new investment. But in most cases the new investment will not be an idle one but will be itself a new "business."

The market sets a *standard* yield for investments, which tends to be followed in outside bargains.

The organization of the investment market is profoundly influenced by the fact that the new issues which it is called upon to distribute to investors are, in general, very large. The initiation of these large issues is a very different business from that of dealing in existing securities, which have already been divided into relatively small parcels, and distributed among the investing public and the dealers in the market. Dealers in these existing securities start with a certain capital of their own, and easily supplement it with borrowed money, because the marketable securities of which their stock in trade consists form a particularly convenient pledge for guaranteeing a banker's advance. Different dealers specialize in different securities, so that no one dealer need keep a selection of all the securities he deals in. If one dealer is asked to sell a security which he does not hold, he has but to turn to some other dealer who specializes in the security in question. In the London Stock Exchange, true to the English tradition of specialization of function in finance, those dealers who keep supplies of securities (called stock jobbers) are an entirely distinct group from those dealers (the stock brokers) who undertake buying and selling orders for the public. The broker (as the name indicates) is an agent or go-between, whose business it is to get into touch with one of the appropriate group of jobbers for the execution of an order, and, so far as he confines himself to this function, his remuneration takes the form of a small commission on the value of the orders. The price-making, which is the essential function of the market, rests primarily with the jobbers, who hold the stock in trade. But the brokers make use of their knowledge of the market to take a hand in buying and selling securities on their own account, and their influence exerts an important effect upon prices.

When a new security is brought out on a scale suitable to be regularly quoted and dealt in on the investment market, what is required is to get it as quickly as may be into the hands of investors. For this purpose a special appeal to investors is required. The procedure adopted to that end differs materially according to the nature of the issue. On the one hand are issues of fixed interest bearing securities, the market value of which depends almost exclusively on the yield, the conditions for the repayment of capital, and the credit of the borrower. On the other hand are issues of ordinary shares, the yield of which can only be estimated

by those who possess an intimate and expert knowledge of the business, and the value of which may be materially enhanced by the indirect advantages of the possession of control.[1] New issues of ordinary shares do not usually come into the market at all. This is partly because neither the dealers in the market, nor, *a fortiori*, the ordinary investors, can be expected to make an informed estimate of their value, and the market is therefore not competent to fix a price. But it is partly, and still more, because control is too valuable a possession to be disposed of to the first comer in the open market. When an enterprise requiring capital is still in the making, the share-capital is provided by private negotiation through syndicates or associations of people possessing considerable resources and interested in the business.

Who then gains access to these syndicates or associations? Their members must be qualified, first by the possession of large investible resources, and secondly by the technical knowledge and experience necessary to make profitable use of control. Investible funds or savings are obtained chiefly from incomes which either, like professional earnings, are derived from no material capital at all, or, like trade profits, are large in proportion to the capital from which they are derived. The latter class are far the more important, not only because their aggregate amount is great, but because very big individual incomes are conspicuous among them. We have already had occasion to notice how the successful merchant has large surplus sums available to be set aside out of his profits, and how the accumulation of such sums provides a guarantee fund to support his credit as a borrower. He is free to invest this fund as he pleases, and the larger it is, the less likelihood is there that it will have to be realized and the less need therefore to place it in readily marketable securities.

The very people then who have large disposable funds to put in shares which are new and unknown to the market, are at the same time those best qualified to make a profitable use of control.

It will be remembered that share capital is needed as a rule not by *mercantile* businesses but by those of production and transport. It was also pointed out above that there is a certain tendency for the businesses of production and

[1] Preference shares, giving prior right to a limited dividend, without the privileges of the debenture holder in regard to security, are an intermediate class, but for our present purpose they must be classed with debentures rather than with ordinary shares as they have little either of the risks or of the control proper to the latter.

dealing to be combined in the same hands. The goodwill of a mercantile business depends upon its connexions with those from whom it buys and with those to whom it sells. A merchant who controls some of the productive businesses from which he buys has to that extent entrenched and secured his goodwill. The goodwill of a productive business is more stable than that of a mercantile business, because the aggregate material equipment of the industry of which the productive business forms part tends to be proportioned to the aggregate requirements of the industry. Under normal conditions no considerable part of this material equipment can remain idle, and the merchant who controls part of it can count on the corresponding share of demand, independently of the chances and vagaries to which unsupported goodwill is subject.

The producer, being also a profit-earner, resembles the merchant in having surplus funds for investment. But he differs from the merchant in that his own business is itself a large field for investment, and is likely, if it is prospering, to absorb a large part of his accumulations for the purpose of capital extensions and improvements. And the stability of the producer's position, in virtue of which his income is better assured, makes saving less necessary to him ; he is likely to spend a greater proportion of his income and save less. Nevertheless producers do figure largely in the syndicates by which new issues of shares are floated. Their motives for acquiring control, however, are usually less concerned with the reinforcement of their goodwill, than with securing supplies of materials or bringing competing businesses into a ring. Transport businesses are in a very similar position to productive businesses in this respect.

The foregoing brief survey of the motives prompting the participators in new issues of shares reveals the important tendency, as more and more capital is put into production and transport, for businesses to be more and more extensively amalgamated.

Although ordinary shares are usually, when first issued, acquired by powerful capitalists, a proportion of the shares in an enterprise of the first magnitude will naturally find their way into the hands of ordinary investors through the investment market. The magnates are satisfied with control. If they hold enough shares to secure this end, they are quite content that the remainder should be held by others. Probably they will keep all their shares till the business is well enough launched for the investment market to form a reasoned opinion as to the value of the shares. That opinion will be

based upon the dividends, actual and prospective, and the price arrived at will therefore include the capitalized value of any element of goodwill by which the company's profits are swollen. This stage once reached, new shares may be created and issued, the position of existing shareholders always being so safeguarded that there is no loss of control.

It will be seen then that the introduction of ordinary shares upon the investment market usually occurs only *after* the most important investors have worked their will upon them outside the market. With fixed-interest-bearing securities, which carry no rights of control, the case is different. Here the appeal has to be made to all classes of investors.

It might be supposed that a simple solution could be found in a sale of the whole issue in the first instance to the dealers in the investment market, they being left to dispose of it, as opportunity might offer, in the course of their ordinary sales to investors. But that is not so. The ordinary dealers would not consent to burden themselves with the whole or even with a disproportionate share of the issue. Their business requires them to hold just so much of this or of any other security as is necessary to support the dealings in the market, and there is no reason why they should buy more.

There must therefore be a special class of dealer to take charge of new issues. It is his business to reach the investor over the heads of the ordinary dealers. First he must fix the price of issue. In doing so he will of course be guided by the prices of similar securities actually quoted and dealt in in the market. But he must allow for the probable opinion of the market as to the credit of the borrower or promoter by whom the issue is being made, and as to all the other circumstances of the issue. And he must also make the price slightly cheaper than the standard so arrived at, for the investors will not absorb the new security quickly unless they are given some inducement to do so.

As a general rule, a capital issue is planned for a definite purpose, which cannot be attained unless the whole is successfully floated. If a part only is disposed of, the enterprise for which those who subscribed intended their money to be used cannot be launched, and the whole project ends in a fiasco. To avoid this risk, it is usual to get a new issue *underwritten.* That is to say, a number of people undertake (in return for a suitable commission) to buy such part of the issue as is not sold to the public. The underwriters need not necessarily be regular dealers in the investment

market, but, even if they are not, they are for the time being, assuming the position of dealers. They are in fact agreeing (should circumstances require) to take up a holding of the new security, not as an investment, but with a view to selling it as soon as investors can be induced to buy it.

The success of the issue depends on the attitude first of those who are approached to act as underwriters and then of the investing public. The issuing house responsible for it must know how to find both, and to appeal to them. The attitude of the underwriters will depend on their opinion as to the attitude of the public. To them the transaction is a speculation. If the public take the whole of the issue, the underwriters have nothing to do, and get their commission for doing it. If, on the contrary, the demand from the public is insufficient, the underwriters are compelled to buy whatever part of the issue remains unsold. In that event the existence of a considerable class of holders who have no intention of retaining the new security as a permanent investment, and who therefore will be seeking to sell, will itself tend to depress the price. And the bare fact of the failure to dispose of the issue is evidence that the price was fixed too high. Probably therefore the underwriters must sell at a loss (which may more than eat up their commission) or else leave some of their capital locked up for a time in the new security.

The fundamental problem before the issuing house is therefore that of getting at the investing public. Where then are the investing public to be found? Large classes of them are to be reached through the investment market itself. They are accustomed to employ the dealers in that market in finding investments for their savings, and to ask the dealers' advice as to which they shall buy.

Next there are special groups whose resources are so large that they are to some extent independent of the market machinery. There are big financial concerns such as banks, which may be large buyers of long-term investments, and life-insurance companies, which are essentially agencies for investing the savings of those whom they insure. Finally, there are the big profit-earning trading businesses to which we have already referred in connexion with issues of shares.

The successful issuing house needs to be in touch not only with the investment market, the banks, and other purely financial concerns, but also with the big commercial businesses. The relations which it must have with all these are, in the aggregate, analogous to the "goodwill" of a trader. But the issuing house differs from a trader inasmuch as it does

not actually *buy* that which it has to dispose of; it acts rather on the footing of an agent. An agent depends upon goodwill as much as a trader, but the goodwill of the issuing house is something much more solid than that of an agent, who need not possess any appreciable capital. An issuing business can only be created by a firm which has itself played a prominent part as an investor. The very same firms which figure in the syndicates formed to participate in new issues of shares are likely to acquire the requisite experience and knowledge to be entrusted with the responsibility for new issues of fixed-interest-bearing securities. Nor can these qualifications be easily acquired in any other way.

Thus a firm acting as an issuing house will be one of solidity possessing a large capital. But this capital will not itself be embarked in the issuing business (except in so far as the firm chooses to undertake part of the underwriting or to acquire a portion of its own issues as an investment). There will probably be a certain amount of incidental banking business; the investors' money to be received as it is paid in; in the case of an international issue, remittances to be effected from one country to another; arrangements to be made for paying coupons, drawing and paying off bonds, etc. Only a firm with a substantial capital could be entrusted with these operations, but they do not themselves employ the firm's capital, which remains free to be invested in participations and other enterprises.

The profit derived from issuing business may be very large. Even no more than one per cent. on an issue of several millions is a big windfall. And this profit is received *concurrently* with the profits that may be derived from the other uses of the issuing house's own capital.

After what has been said, it is obvious enough that a bank with adequate capital is as well qualified as a successful merchant to deal with new issues, not merely with fixed-interest-bearing securities, but with ordinary shares. If it takes up the latter business, the bank must, it is true, be qualified not merely to judge of the value of the shares but also to take up the responsibilities of control. But to secure the latter qualification, all that is needed is the appointment of individuals with the appropriate ability and experience to the directorate of the bank.

It is only in countries of outstanding commercial development that there is a class of merchant-financiers adequate to deal with the business of new capital issues. Where this condition is not fulfilled the predominant part in the business

is played by the banks. The capital of the banks has probably itself been collected through the machinery of the investment market, and in some countries the demand for accommodation in the form of short-term loans and discounts is insufficient to use up the banks' resources, so that their investible capital is reinforced by a part of their deposits. It may also be mentioned that where the investment market itself is insufficiently developed, people are apt to leave their savings on deposit in the banks, subject to withdrawal at a fairly long notice, and yielding a rate of interest not far below that of a long-term investment. Against such deposits it is perfectly reasonable to hold in part long-term investments as assets.

It is remarkable that in pre-War Germany, which was perhaps the greatest commercial country next to England and Holland, capital issues and particularly participations in industrial concerns were very much in the hands of the banks. This was partly due to the rapidity of the economic development of the country. The great merchants had not had time to accumulate savings proportioned to their profits. German commerce also, as it grew, had to get financial support from London and Paris, and the great German banks, not having readily obtained enough bills and liquid assets, were led to seek industrial investments.

In England and America the banks properly so called do not ordinarily act either as issuing houses or to any considerable extent as underwriters. But they do not wholly disinterest themselves in new issues. It is of material consequence to underwriters, to stock dealers and to investors that any new security that they take should be of a kind that they can obtain advances upon from a bank. A favourable opinion from prominent bankers will therefore conduce substantially to the success of any capital issue.

CHAPTER VIII

COST OF PRODUCTION AND RENT

WE have already had occasion, in dealing with markets (Chapter III), to use the expression, Cost of Production. The conception underlying that expression is by no means a simple one.

In our exposition of the economic organization of society we have been chiefly concerned so far with exchanges and the markets in which exchanges are effected. People only exchange things which require *effort* to produce or to procure. No one will sacrifice anything in exchange for that which can be had without effort.

Effort, as we saw, commands a price in the labour market, a price which takes account of the quality as well as of the quantity of the effort. The amount of effort required to produce a commodity can therefore be measured in terms of money.

Besides labour, the production of commodities also requires the use of capital. The use of capital in production may be regarded as a method of economizing effort, and the money-price of it, represented by interest, enters, as much as labour, into cost of production.

What is the relation of the price of the product to its cost of production? There is a sense in which the two may be said to be necessarily equal. If production be taken to include *all* processes leading up to consumption, not only those of industry and transport, but those of marketing, then the cost of production must include the remuneration of the effort devoted to marketing. This remuneration takes the form of profit.

It may be that profit supplies in many cases a remuneration out of all proportion to the effort to be rewarded. But it is the remuneration which the economic organization of

society does actually yield. In reckoning the cost of production we do not attempt to estimate what the remuneration of each kind of effort ought to be ; we only ask what it *is*.

The whole of the price received from the ultimate consumer of the product goes to pay those who contribute, either by their own services, or by the use of their property, to the consumer's satisfaction. Each producer or dealer who has so contributed has paid away something to those whom he employs, and has incurred expense either for the purchase of materials, or (in the case of a dealer) for the purchase and transportation of the finished product itself. To each the balance remaining, after meeting all such expenses, and paying interest on capital and similar charges, is his remuneration.

But for our present purposes we need a narrower definition of cost of production. The analysis in Chapter V clearly shows that profit differs profoundly from other forms of remuneration, and we shall be doing no violence to usage if we exclude profit from cost of production, and say that profit is the excess of the price received over the cost of production.

But this definition is by no means so simple as it looks. A manufacturer's costs, besides wages, salaries and interest, include payments for materials. The prices paid for the materials include the profit of the producers or dealers from whom they are bought. These latter in turn have bought things from yet others, who have secured a profit on the way, and transport charges likewise include a profit. A logically consistent exclusion of profit from cost of production would mean the elimination of the element of profit at every separate stage, and even of so much of the charges for interest as is attributable to the portion of the initial outlay on fixed capital which represented the contractor's profit.

But it is not really necessary to make use of a logically consistent concept of cost of production. We may be content to give the expression the meaning which it has for an individual producer, who considers the productive process only at the stage at which he himself intervenes, and who reckons all his payments as costs, even though a part be destined to form the profit of another trader.

The producer sells in the wholesale market, and his profit is the excess of the wholesale price over cost of production. As we saw in Chapter V, so long as output remains normal, the ratio of profit to cost tends to approximate

to a fixed standard. This standard rate of profit, in all industries, will tend to be just not so high as to tempt outside competitors. But the working of this simple principle is obscured in practice by the wide and incessant variations to which output is everywhere subject, and by the consequent variations in the cost per unit produced.

The nature, extent and causes of such variations of output are different for different industries. Some of these differences it will now be desirable to study.

In the first place we may make a broad distinction between those industries which derive materials, whether for food or for manufacture, direct from the earth, and those which apply further processes to such materials. The industries of the former class may be divided into agriculture (including forestry) which produces organic matter from the soil, whether by tillage or by tending livestock, and mining (including quarrying) which extracts materials from the earth's crust itself.

In the case of agriculture the labour of cultivating a given area up to a given standard, with a view to the production of a certain crop, represents an approximately determinate cost. But the output or crop depends on a number of physical conditions. Not only will it be greatly affected by the state of the weather at the critical stages of growth, but it may be impaired or sometimes almost destroyed by such fortuitous causes as insects or pests. For a given holding, cultivated up to a given standard, it may be possible to estimate a "normal" or "average" crop. But that is an abstraction. There is no normal weather, and there are no normal pests. The actual crop may be substantially above the normal expectation, or far below it. In an extreme case it may be practically nothing. The cost of production is inversely proportional to the crop.

In the case of mining, productivity is also often very much a matter of chance. This is chiefly due to the difficulty of foreseeing what the physical formations below the earth's surface will be. In the first place it is a matter of doubt whether the minerals sought are to be found at all, till a shaft has actually been sunk. Secondly, even when the minerals have been found, the actual amount of labour needed to work them depends upon a variety of physical conditions. But mining differs from agriculture in that, as a mining area is developed, and experience of the physical conditions is obtained, the element of chance is diminished, and the cost of obtaining a given output can be more and more closely estimated.

In manufacturing industries, that is to say, those which use materials *after* removal from the earth, cost of production is affected on the one hand by variations in the supply of materials, and on the other by variations in the demand for the finished product.

Variations in the supply of materials affect cost of production most directly and obviously by affecting the market prices of the materials themselves. The prices of the materials are affected, because the supply of the finished products into which they enter is affected, and the prices of these finished products are dependent upon supply. If a shortage of raw silk raises the price, that is because the output of silk goods is limited by the supply of raw silk, and a shortage of supply of silk goods will raise their prices. From the increased prices of silk goods the producers can afford to offer a higher price for raw silk.

But besides these price reactions, cost of production in manufacturing industries is also affected, as we have already had occasion to notice, by the relation of output to capacity. Output may fall below capacity, either because of a shortage of materials, or because of a decline in demand, or because of increased production by competitors. Whatever the cause, the cost of production of each unit of output is increased, because there will be overhead charges and other expenses, which either are fixed or do not diminish in proportion to output.

In transport enterprises the cost of production is even more affected by the relation of business done to capacity than in manufacturing enterprises. A very great part of the cost of transport takes the form of capital outlay (e.g., on railways, roads, vehicles, ships, harbours). This capital outlay is undertaken, and the corresponding organization is set up, in anticipation of a certain volume of traffic. The further direct expenditure, proportional to the traffic actually handled, is usually relatively less than in a manufacturing industry.

Those who start productive enterprises, and embark capital in them, look forward to a profit. In calculating the profit, they have to take account of the probable variations in cost of production. So far as these variations are dependent upon chance, they must take the risks. They must rely on probabilities and averages.

But there is one fundamental respect in which the variations of cost are not a matter of probabilities and averages, but of calculation and foresight. Cost is affected by the advantages and disadvantages of *locality*.

If we may be permitted for the present to leave out of account the political and social conditions of the human community in which a place is included, the local advantages and disadvantages fall mainly under two heads, first the natural resources and characteristics of climate and soil, etc., which affect the physical productivity of effort at the place in question, and secondly the communications with other inhabited places, either as sources of supply or as markets.

The human race tends to distribute itself in the places where its productive efforts are most fruitful. One of the governing conditions of distribution is the need for a supply of organic products, especially for food, but also as materials for clothing and for other manufactures. The cultivation of the soil for the purpose of providing these organic products necessitates a population spread more or less evenly over the productive area. Under primitive conditions, when the facilities of transport are slight, far the greater part of the population is so occupied. They feed on their own produce, and use their own materials in the essential manufactures of clothing, household goods, and agricultural implements. The division of labour is in an elementary stage.

A primitive population so occupied chooses for settlement the most fertile land. Accessibility is a secondary matter.[1] In proportion as communications improve, the division of labour develops, more produce is marketed, and less is consumed by the producer. Accessibility then becomes a more desirable attribute. When goods are produced for market, the cost of transport to the market becomes virtually part of the cost of production. The cultivator, in calculating the profit to be made from a particular piece of land, must add the cost of transport to market to the outlay necessary to produce crops on the land itself. It is only after the total cost so arrived at has been met, that the balance remaining of the market price will be profit.

It is obvious that differences in fertility and differences in accessibility may make very large differences in the rate of profit to be received from a given outlay on capital and labour on different pieces of land.

The same is true of mines and quarries. The products of mines and quarries must in any case be marketed. And though quarries can sometimes be satisfied with a purely local market, mines nearly always need to find purchasers

[1] From the point of view of defence inaccessibility may be a positive advantage.

over a wide area. Coal and metals are only to be found in certain limited areas, but are everywhere in demand. For them therefore (and especially for coal and iron, which are bulky in proportion to value, and are used in enormous quantities) communications are of paramount importance.

Mines also differ in productivity as much as agricultural land. The amount of labour required to bring a given quantity of mineral to the surface differs widely according to the depth and conformation of the mine. But quite apart from that, the total amount of the mineral in the mine, however great it may be, is limited, and the initial capital cost of sinking shafts and opening up the mine must be made good out of the proceeds of sales, during the life of the mine, before anything can be counted as profit. When the mine is exhausted, the capital sunk in it will no longer be represented by anything of value. This capital must be made good out of a depreciation fund, which must be provided for in the price at which the mineral is sold, and thus constitutes part of the cost of production. The smaller the total quantity of mineral to be ultimately obtained from the mine, the greater must be this part of the cost of production for each unit of output.

Agriculture and mining are essentially *localized* occupations, tied down to the place where the land to be cultivated or the mine to be worked is situated. The manufacturer on the other hand is free to choose any convenient place for his activities, and the materials and labour required can be transported thither. Whereas the lines of communication must be adapted to the position of mines or crop-bearing land, the position of manufacturing establishments is in turn adapted to the lines of communication. They spring up at centres which have convenient access on the one hand to supplies of materials and of food and other commodities for the workmen, and on the other to markets for the finished product.

Finally the great markets themselves are established at centres of communication. It is not necessary that the goods dealt in in a market should be physically present there. It is the *dealers* who must be assembled together. Sometimes it is an advantage that the goods bought and sold should be near at hand and available for inspection. Then the market is restricted to centres through which the goods themselves must pass. But the biggest markets deal in commodities which either can be standardized, or can be judged from samples. Freed from any necessary local connexion with the commodities dealt in, these markets tend to be con-

centrated in great cities. In great cities also are concentrated those financial markets, of which the subject matter is not commodities at all, but investments and credit.

In subsequent chapters the local distribution of economic activity and the consequent local distribution of population will claim a large share of our attention. At this point all we are concerned with is the relation of cost of production to locality.

Local advantages, whether of position, or of physical properties, such as fertility, are tied to whatever fixed capital occupies the locality. The fixed capital is inseparable from the place it occupies, and the local advantages may be regarded as adding something to the value of the capital. The capital, as we have seen, commands value as a means of saving cost. Cost is similarly saved by the local advantages. When the fixed capital with the local advantages, is bought and sold, the price at which it is quoted is based on both these elements.

That is so, when the fixed capital has once been brought into existence. But what of the case where vacant land is sold to be brought into use? On that occasion it is dealt in separately from the fixed capital by which it is later on to be occupied. The purchaser will be willing to pay for it a sum not exceeding the value of its local advantages for the purpose for which he destines the land. The owner will endeavour to seek out that purchaser who will pay highest for it, and thus the land will tend to be put to the most profitable use for which it is fitted. If this use is one requiring an elaborate fixed capital, then, once the land is disposed of, and the capital constructed, the value of the land, as vacant, becomes an abstraction, and remains so during the lifetime of the capital. The decision as to the use that is to be made of the land, when it comes into the market still vacant, may therefore pledge the future for a long time to come.

Dealings in land are a part of the subject matter of the capital market. When funds are raised for the purposes of investment the acquisition of land is one of the objects to which they may be applied. Sometimes (especially in "new" countries) vacant or undeveloped land is bought in large amounts as a commercial venture by companies or syndicates, to be sold as and when purchasers can be found. In that case the land is dealt in just like merchandise, which is bought and sold by a dealer. More often an owner who wishes to dispose of his land will employ an agent to bring him into direct touch with a purchaser. The land may be

vacant, or it may already be developed and occupied by fixed capital adapted to some use. Sometimes, although occupied by fixed capital, it nevertheless commands a higher value for some different use, and the purchaser finds it profitable to demolish the existing structures and treat it as if it were vacant land.

Land, whether vacant or covered, is not necessarily sold for a capital sum; it may be let or leased for an annual payment. The lessor may be regarded as an investor, the land being his capital, and the lessee paying interest upon it in the form of the annual rent agreed upon in the lease. Such bargains are of the kind that are made outside the investment market properly so called, but the terms on which they are made are practically governed by the rate of interest prevailing in the market. They are especially common in the cases of agricultural land where the amount of fixed capital required is not great relatively to the land value, and of dwelling-houses, where the lessee is not a trader but a consumer.

We have seen that the rate of interest in the investment market tends to express the ratio of the earning power of the capital which it is just worth while to instal, to its cost. In the case of vacant land this ratio has no meaning, because there is no capital cost. The capital value of vacant land, or such part of the capital value of covered or developed land as represents its value as vacant or its local advantages, is derived from its *annual* value or labour-saving capacity. The number of "years' purchase" of this annual value is the reciprocal of the market rate of interest.

The value of the local advantages of land or its value as vacant is often called "land value," and the annual payment made for it is called "economic rent." Economic rent is different from what is called "rent" in ordinary parlance, for this latter includes the annual sum paid for any developed land or fixed capital. Rent, in that sense, is divided by the economist into economic rent, which is attributable to the land value, and interest on the fixed capital and improvements. The improvements ought theoretically to include every feature of the land which is due to human effort *applied within its boundaries*. But the consistent application of this theoretical principle is quite impossible. The land value of any particular property is of course to a very great extent the result of human effort applied to surrounding properties, partly in the development of communications, but also in making these surrounding properties habitable and productive. If a large landed estate

has been developed by the making of roads, the clearing of forests, the draining of swamps, the construction of buildings, and similar improvements, each small parcel of the estate will have its value enhanced by the development of the rest, and, if the parcel be considered in isolation, the increment of value will be land value. But, if the whole estate be considered as a unit, the return from improvements in one portion may be found in the form of enhanced value in another.

Thus the distinction between land value and interest on capital would seem to depend upon the accidents of ownership. If we ask what would be the value of a piece of land if vacant, the question is a hypothetical one, and the answer depends upon the precise nature of the hypothesis. How much land is to be assumed vacant? Are the local advantages to be valued for the purpose to which the land is actually put, or for the most profitable purpose to which a man purchasing it vacant could apply it? What degree of efficiency and what degree of good fortune must be assumed in carrying on the business for which the land is to be used?

In the actual dealings of the capital market economic rent is subject to the limitations imposed by the rights of property. The land values that have practical significance are those of the actual parcels of land which are sold or leased, with the fixed capital and improvements (if any) actually upon them. When vacant land is dealt in, its potentialities are calculated by both the landowner and the purchaser or lessee. The calculation is a difficult one. Not merely must the existing local advantages, e.g., the accessibility of markets or of sources of supply, be estimated, but future changes must be allowed for. Communications may improve, or on the other hand the communications of rival undertakings may develop. The demand for the products to be derived from the land may fall off, and the local advantages thus become less valuable, or on the other hand demand may grow and the local advantages become more valuable. As population shifts, the centre of gravity of demand may move further away from the land or may approach nearer to it. He who undertakes to develop land, and pays the owner for it, is entering upon a highly speculative venture, and will probably make some allowance in his own favour for the risk in the price or rent he offers. The market in vacant land reflects the buyers' and sellers' estimates of the land values dealt in; it has the equalizing influence characteristic of all markets, and tends

to reduce the profits of all those who make use of land to a common level, since each has to pay to the owner the equivalent of any special advantages of the land he occupies. But the equalizing influence is imperfect, partly because of the difficulty of foreseeing the future local advantages, and partly because, in a growing community, there is a general tendency for local advantages of any given piece of land to grow progressively greater.

Thus, even after allowing for the differences in the rent or purchase price of land occupied, there are still wide local differences in cost of production, and corresponding differences in profits.

We are now in a position to take up again the question of the effect of changes in demand or in price upon supply. Take the case of a market drawing supplies of some commodity from a number of neighbouring centres of production. The producers will all have entered business with the expectation of making a normal profit. But such is the uncertainty of productive undertakings that the actual profits made will vary materially from those expected. Some businesses will be making profits very much above the normal, others very much below, and some may be actually working at a loss. The variations will be due partly to pure chance, partly to the personal qualities of the producers and their employees, partly to the local conditions of the places at which the business is carried on. There will ordinarily be a few businesses, where conditions are specially adverse, dropping out of the trade altogether. Either they are closed down, their plant scrapped, and the land disposed of for some other purpose, or perhaps their capital equipment can be adapted by less radical changes to some other form of production. Others will be sold as "going concerns," and a change of ownership and management may enable them to become successful.

Thus there is a steady elimination of the unfit (or unfortunate) both among the producers and among the places occupied for production. The relative advantages of the different businesses can be as well expressed in terms of cost of production (including transport to market) as in terms of profit.

The equilibrium point at which supply balances demand is often said to be that at which price is just sufficient to cover cost of production for the "marginal" producer, that is to say, for the least successful producer that manages to remain in business. And it is further argued that profit is essentially a *differential* gain like the rent of

land. Just as economic rent is paid for the advantages of a piece of land over the marginal land, so, it is said, profit is paid for the advantages of a business over the marginal business.

If that were so, it would be normal for the marginal business to yield no profit. But a man will not enter a business that promises him nothing in excess of the return he could expect by merely lending his capital. He must have a sufficient profit to yield him reasonable remuneration for his exertions. In fact the marginal business must not only cover costs, but must yield a normal profit in addition.

This seems to be contradicted by experience, because some businesses are to be found earning less than the normal profit, or even working at a loss. But that is due to the vagaries of fortune which cannot be foreseen. The man who expected to make a normal profit may find himself making either more or less. This may be due either to his own greater or less efficiency or to circumstances beyond his control. No clear line of demarcation can be drawn between misfortune and fault, for it is impossible to say with certainty which contingencies could have been foreseen and guarded against, and which could not. Whatever the cause, some people who expected to make a normal profit are disappointed. Some, no doubt, make an additional profit by their own special skill and efficiency and this additional profit is a genuine "rent of ability." But that applies only to the excess over the normal profit.

Where a trader's disadvantages (personal or other) are such that he cannot make a normal profit, he will not stay in the business, except when this is a temporary necessity to save his capital from loss. If he cannot use his capital in any other way, he will stay in the business so long as he is covering his costs, and even for a time while he is making a loss. On the other hand, if his capital can be turned to another use without serious waste or loss, he may be induced by a moderate fall of profit to make this change. This is especially so in agriculture, where the same land can be adapted to a variety of uses, and the farmer will turn to that one of them which offers for the time being the best prospect of gain.

Where the capital cannot be adapted to another use, it may nevertheless be scrapped with comparatively little loss in a business where the depreciation charges are in any case very heavy. Every time big renewals of plant become necessary, there is an opportunity of saving the expenditure they would involve, as some set-off against the abandonment

of such parts of the plant as could have been kept in use. This is especially so where depreciation has to provide not only for wear but for rapid obsolescence.

Profits vary widely even for the same business from time to time. It is only after extended experience that a trader can estimate whether he is making or can expect to make a normal profit. The margin is not a definite line, but a broad *penumbra*. Nevertheless we can in principle identify the marginal producer as the producer who is making a normal profit. All aim at getting a normal profit, and, if some of those who have the requisite capacity fail to achieve it, others get more; in so far as the variations are due merely to chance they tend to average out. Those who have not the requisite capacity are birds of passage; their sojourn is only prolonged by the hope of saving their capital.

From the point of view of an industry taken as a whole the capital lost in the unsuccessful concerns is part of the cost of production. Anyone who embarks capital in the industry requires an extra payment above the market rate of interest as compensation for the risk of loss. The amount of the extra payment depends upon the capitalists' estimate of the risk. It tends to be *more* than an exactly calculated insurance premium upon the risk, because for most people a possible loss of capital is an evil greatly outweighing an equal chance of an equal gain.

The risk to the individual capitalist is also more than the risk to the industry. The loss to the industry is limited to the capital put into it which either is abandoned, or, if continued in operation, fails to earn a reasonable return, owing either to mismanagement or to some miscalculation of costs or of demand. In addition individuals have to bear losses arising from a failure of goodwill. That is to say, their undertakings become unremunerative because their capital is under-employed, and probably in the end are wound up, and their plant is acquired by their successful rivals. This risk operates as a deterrent upon newcomers entering the industry. Strictly speaking the extra return upon capital which really represents the risk of loss ought to be classed as part of cost of production, and the rest as extra profit. An exact line of demarcation would be impossible to draw.

When the demand for a product expands, increased orders are given to the producers. As we have already seen, the effect in the first instance is to stimulate production, without any increase of price, up to the limit of the producers'

capacity. If this is insufficient to meet the increased demand, the producers will begin to ask higher prices, and their profits will accordingly rise. If the expansion of demand appears likely to last, fresh capital will come into the industry. Production will become profitable under conditions and in localities where it would not have been profitable before, and theoretically the new capital ought to come to such localities. The position of the "margin" of production is changed. In some kinds of production this is so in practice, as well as in theory. In almost every form of agriculture the cost of production (though very much affected by weather and other variable factors) is definitely dependent upon locality, and the margin of cultivation is very clearly marked. The increase of demand for any particular crop brings a new zone of land into cultivation for the crop. At the same time all the land already producing the crop is affected. In the first place, apart from any change in production, it yields an additional profit, which is in the nature of an additional economic rent. Secondly a part of the additional demand can be met, not from new land, but by applying more labour and capital to the more favourably circumstanced land already under cultivation. Before the expansion in demand it presumably would not have been profitable to apply this additional labour and capital, or at any rate the producer did not think it would have been profitable, for if he had he would have taken steps to secure the profit.

It is commonly said that agricultural production conforms to the law of "diminishing returns," that is to say that as more and more effort, in the form of labour and capital, is put into a given piece of land the increment of output secured by each new increment of effort becomes less and less. This is not a physical characteristic of cultivated land in all stages; but, so long as additional effort applied to land already cultivated yields at least as much in proportion as the preceding effort, effort will continue to be applied to more intensive cultivation on that land rather than to opening up new land. *Sooner or later* a limit must be reached at which the yield of additional effort is found to fall off, and any land which is cultivated at all tends to be cultivated up to this limit

When an expansion of demand occurs, the additional supply comes both from intensified cultivation of the old land, and from the cultivation of new. The economic rent of both is increased, and the people interested in the land receive the benefit. In the first instance the benefit will

accrue to the actual occupier who is working the land, whether he be absolute owner or leaseholder. When a lease expires, the owner, in granting a fresh lease, has the opportunity of securing the additional economic rent for himself.

Mines respond to an expansion of demand in much the same way as agricultural land. That is to say, an intensified working of existing mines becomes profitable, and new mines, which formerly could not have been worked at a profit, are opened up.

When an expansion of demand requires an increase in the output of an agricultural or mineral product, the extra output will in general be supplied in part from the cultivation of new land or the working of new mines. The case with a manufactured product is or may be somewhat different. The product in question is presumably being manufactured at a number of places, chosen for convenience of access to markets and to sources of supply of materials. The amount of space needed for a manufacturing industry is relatively small, and it is usually possible to increase the capacity of the industry, at any centre where it is already established, very largely, without losing much of the local advantages. The increase of capacity may be obtained either from starting new concerns or from extending those which already exist. If this can be done without any increase in cost of production, then the law of diminishing returns does not apply, and the increase of demand can be met without any rise of price.

We have already seen that, if a manufacturing concern is not employed up to its full capacity, the cost of production is raised, because the overhead charges are spread over a smaller output. If the capacity is extended it may be that the overhead charges are little if at all increased. Further as the total output grows greater, it becomes worth while to employ new kinds of plant and labour-saving devices, which are not economical unless continuously in use, and will only be continuously in use if the output to which they are applied exceeds a certain limit. Thus it often happens that, as demand increases, the cost of production actually falls, and the product is then said to conform to the law of "increasing returns." An industry so circumstanced is in an unstable condition. An extension of demand will lower the price, and the fall of price will still further stimulate demand. The movement will end in a new equilibrium position, when either the economies to be obtained from a further increase in output have ceased to be considerable,

or demand is so satiated that it ceases to respond to a further fall in price.

The scale on which a manufacturing concern is carried on depends upon the extent of its market, which in turn depends upon the means of communication. A great extension may be made possible not only by a general growth in demand, but by an improvement in communications. Two manufacturing businesses, each supplying a limited market, may by such an improvement gain access to one another's markets. If one is producing on a larger scale than the other, and producing for that reason at a lower cost, it may drive its competitor entirely out of business, and as a result of this extension of output produce at a lower cost still. By this process an improvement in communications brings about a concentration of manufacturing industry in larger establishments, till the limit is reached at which an increase in the scale of production ceases to realize economies.

With a commodity like sewing cotton, for which the cost of transport over great distances is small in comparison with its value, the small manufacturers only exist anywhere on sufferance. In the heavy industries (iron and steel and big engineering products) the case is more complicated. In them the advantages of production on a large scale are particularly great, but at the same time the cost of freight to a distant market is high. They must be carried on within reach of adequate supplies of coal and ore, and the big works are thus tied down to the big coal fields. Smaller works, at which the immediate cost of production is much higher, may nevertheless have a decisive advantage in the markets close to them.

Bitter competition sometimes rages among the big works in markets remote from all of them. If a manufacturer of iron and steel products is working below the capacity of his plant he can afford to take a contract at a very low price, because the additional output will involve a much less than proportional increase in his total outlay. And even if a contract involves an extension of plant, it will yet be worth while to accept it at a low price, provided the manufacturer anticipates that the extended plant can be employed at or near its capacity in the future. Accordingly sales at apparently ruinously low prices are a common incident of the heavy industries.

Next we turn to marketing. Marketing has its costs, though these, if distinguished, as they should be, from the cost of transport and of the physical handling of the goods

dealt in, are far less in proportion to profit than the costs of manufacturing.[1] The cost of transport is usually defrayed by the merchant or dealer, but he buys transportation in the same way that he buys goods. Storage is more definitely part of the merchant's business, for whereas transportation is an essential part of the physical process of making the goods available to the consumer, the need for storage arises in part from the merchant's convenience in adapting his purchases and sales to the state of the market. Without transport the process of production itself would be incomplete; without storage (otherwise than in the ultimate consumer's hands) the adaptation of production to consumption would be effected very irregularly, and there would be extreme variations of price, and possibly great waste, but production would still culminate in consumption.

In the case of the retail dealers the cost, not only of storage, but also of displaying goods and making them readily accessible to purchasers is part of the cost of the business.

We have seen however that some wholesale markets exist detached from any physical proximity to the goods dealt in, and that they become situated along with the financial markets at great centres of communication. The direct costs of the dealers in such markets are limited to the expenses of a clerical staff, office accommodation and similar items. But facility of communication is so essential to them that it is worth their while to pay very highly for apparently quite small local advantages. In part these local advantages are a direct saving of expenditure on locomotion and on office staff, but to a far greater degree they are a support to the goodwill of the firm which enjoys them. Despite all latter-day excellences in communication, personal interviews in important business cannot be entirely dispensed with. A central situation, by economizing the time of the responsible heads of a mercantile or financial concern, enables them to transact a greater volume of business. It is owing to this transcendent advantage that the most advantageous sites for office accommodation in great cities command fabulous prices. The huge city ground-rents are really a by-product of the huge incomes amassed from profits. In fact the big incomes of the merchants and

[1] By "costs of manufacturing" here is meant not the whole cost of production, but the cost of the processes applied to the material. In the case of marketing, cost of production, if it included cost of materials, would have to include the whole of the dealer's outlay upon the purchase of goods.

financiers are reflected in the high value of everything that contributes to their activities. Sites for dwelling-houses in great cities, and fees of barristers in commercial cases are other examples.

Sites suitable for big shops also command a high value, though not on the whole so high as for business offices, because retail business is less centralized.

CHAPTER IX

THE DISTRIBUTION OF POPULATION

IN the preceding chapter we considered cost of production and local advantages in relation to the profits of the individual trader. Now we shall turn to a wider aspect of the question. People must live where they work, or at any rate not further off than the daily means of communication will permit. The local distribution of work means the local distribution of population.

Under primitive conditions, when there is little division of labour, the vast majority of human beings are engaged in producing the means of their own subsistence from the soil by their own care or efforts. The form that subsistence takes depends upon the qualities of climate and soil. In one region man hunts, and lives chiefly on the flesh of wild animals. In another he is nomadic, using the flocks and herds, which he drives from one pasturage to another, as an instrument for transforming grass and herbs, which he cannot himself consume, into flesh and milk which he can. In other regions he stimulates the productive properties of nature by cultivation; there his subsistence is more varied in character, but is still limited in its range to the products of his immediate environment. His principal vegetable food will be determined by soil and climate. It will be wheat or rice, maize or potatoes, dates or yams according to circumstances.

In the materials chosen for making clothes and constructing shelter and meeting other human needs man shows a similar adaptability.

The population of any region is limited, under such conditions, by the subsistence and the necessary materials that the region itself provides. In this respect man resembles the animals, except that his adaptability enables him to survive and multiply in a greater variety of physical conditions than any animal. The population of any area grows till numbers begin to outstrip resources. If we leave out of

account for the moment the possibility of a limitation of population either by a natural or deliberate diminution of the birth-rate, or by infanticide, this excess population either must lead to an increased mortality or must be relieved by *migration*.

Nomadic man is in a state of chronic migration. The amount of subsistence to be derived from pasture is so small that a community wholly dependent upon it must be perpetually moving. The mobility of the primitive Germans, the Arabs, the Tartars and other nomads has been a mighty influence in history.

But a given area can support incomparably more people when cultivated than when merely grazed. Ever since the remote period when the art of tillage was originated and suitable grains and other crops developed, the tendency has been for man to postpone the population problem by a more and more intensive cultivation. In this process the land with the greatest local advantages will be settled and cultivated first. For primitive settlers the principal local advantages will be fertility, defensibility, and freedom from obstructions (such as timber or swamps). Means of communication for the purpose of trading with other communities are in the beginning but little regarded.

As the settled communities increase through natural growth of population, they tend to spread over the surrounding land. As less and less eligible land is settled, the inducement to cultivate new land is weakened, and a part of the extra population remains on the more eligible land previously settled. The two processes of extension over new land and the more intensive settlement of the old go on side by side.

The extension of settlement into the less eligible contiguous land can hardly be described as migration. So long as the land formerly rejected as unsuitable for settlement is being taken into cultivation, at the cost of expending a greater and greater effort on a given amount of subsistence, the standard of living is falling. In other words the pressure of population upon the means of subsistence is being felt.

Relief comes when *new* land, more eligible than that on the margin of cultivation, is discovered and settled. It is the settlement of this new land, which was not considered in the original choice of land for cultivation, that constitutes migration.

Such new settlements still do not necessitate communications suitable for trade. All that is required is such means

of access as will enable the original settlers to move, once and for all, into their new home.

The problem of the distribution of population is completely transformed as soon as the division of labour comes to play a part in it. Settlers no longer look only to the capacity of the land to produce food and materials for their own consumption. They seek land that will produce *any* useful commodities, provided only that adequate means of communication exist to carry the commodities to markets where they can be exchanged. Means of communication, though they depend upon natural features, require much human effort to complete them for use according to modern conditions. The development of means of communication by human effort is one of the governing factors in the distribution of the population of the world. Both the development of the means of communication and the installation in each new area, as it becomes available for settlement, of the requisite fixed capital, including dwelling-houses, are slow and gradual operations. They and the movement of population are all closely interdependent.

The first step is likely to be in the direction of improved communications. From remote times the leading part in the communications between one part of the world and another has been played by the sea. Sea transport involves a certain amount of capital outlay, but much less in proportion to the traffic carried than land transport. And of the capital used in sea transport the greater part is *movable*. A sea-going ship can be readily changed from one route to another, wherever there is need for the services it is fitted to perform, provided only that it is of a size suitable to use the harbours that are available, and to navigate the seas that have to be crossed. The fixed capital required for sea transport is limited to the harbours and docks at which ships are loaded and unloaded, and a few other items such as lighthouses. Almost every coast has its natural harbours, capable even without improvement of giving ships shelter. Capital expenditure is principally required to give better facilities for landing and loading cargoes, to supply warehouse accommodation for the goods after landing or before loading, to make the shelter complete against the extremes of bad weather, to secure adequate depth of water, and to provide arrangements for repairing ships. In most cases the use of a natural harbour can start before any of these improvements are effected ; they can be carried out piecemeal, as and when the need for them is felt and the volume of traffic justifies the outlay.

It is hardly too much to say that the human race has access by sea to every coast in the world. Even before the invention of steamships this was so, for voyages of half the circuit of the earth, despite the length and uncertainty of their duration, were regularly undertaken by sailing ships. Nowadays the sea affords a highly efficient method of access from every harbour in the world to every other, and the most distant voyage takes no more than a few weeks, or at the slowest two or three months.

In all questions of settlement therefore the problem of sea communication may be taken as solved, so far as harbour accommodation permits. But when it comes to the practical use of sea transport there is still another condition to be fulfilled. A ship is capable of carrying a large quantity of goods, and it is not an economical means of transport if its cargo is very far below its full capacity. Even in the days of sailing ships this condition was a serious limitation, for an ocean-going vessel would be capable of carrying some hundreds of tons. A modern ocean-going steamer carries several thousand tons. If a trading community depends upon a port for its oversea markets, it needs, not perhaps an absolutely regular service of ships, but at any rate such an approach to regularity as will enable them to count on their products reaching market in a reasonable time. These conditions will not be fulfilled unless the trade passing through the port is sufficient to fill a sufficient number of steamers in the year, without serious risk of their having to perform empty voyages or to suffer long delays in waiting for cargoes. Consequently even though the physical conditions exist for adequate communications through a port, the communications may remain a mere potentiality until the district served by the port produces enough commodities for overseas markets to employ shipping on an economical basis.

The fulfilment of this condition will depend on the landward communications. There must be roads and railways (or inland waterways) connecting the port with centres of production. The problem of land transport is the same whether the point of connexion is a seaport, or a junction with an existing system of inland communication. The new land is not necessarily in a new country. It may have remained undeveloped right in the midst of an ancient civilization, till some economic, social or political change made it for the first time profitable for settlement and exploitation, and justified the improvement of its communications.

The development of land communications is a *discontinuous* process. The railway prospector looks round for some region, not hitherto tapped, containing natural resources, organic or mineral, suitable for transport to other markets, and extensive enough to pay the overhead charges, and working expenses of his proposed railway, and to leave over an adequate margin of profit to justify the investment of capital. This cannot be fully realized till a sufficient population has been attracted to develop the new land. It is obvious that, if settlement and development are to proceed fast enough to realize such expectations within a reasonable time, the local advantages of the land, when completed by the construction of the railway, must be immediately and obviously substantial. Settlers would not come, or would only come in small numbers, if the advantages of the new land over the old were slight.

The local advantages of new land may reach the requisite level in either of four chief ways. In the first place the mere growth of population in the old communities may raise the value of natural products relatively to the value of human labour, and so increase the profit to be made from a new source of supply of such products. Secondly, exploration may reveal regions more productive than those already exploited. Thirdly, the progress of invention may find profitable use for products previously regarded as valueless, and lead to the exploitation of land where they are found. Finally, improvements in the methods of transport themselves may promise increased local advantages from the exploitation of land previously treated as too remote to be worth developing.

Any one of the three latter may bring a very large area at one stroke within reach of development. This is especially true of the last. The invention of steam transport, by land and sea, suddenly made possible the exploitation of whole continents that till then had been hardly touched. But the rate of progress is limited. It is limited both by the resources of the capital market, and by the amount of labour that can be maintained on the spot. The men employed on railway construction must be fed and housed, and the number that can be provided for depends upon the existing communications. When a stretch of railway is completed and working, the influx of settlers into the district which it serves begins. The settlers require dwelling-houses, roads and all forms of fixed capital. Here are new demands both on the capital resources available for the country and on the labour supply, to compete with the needs of further

railway construction. The development of a large area, even if all its potentialities could have been accurately estimated at the beginning, may yet take generations or even centuries.

Exploitation is concerned in the first instance with fresh supplies of agricultural and mineral products, because the productivity of the land already settled cannot be indefinitely increased. To exploit natural resources, whether agricultural or mineral, the people must go to the land where these resources are to be found. If they cannot be induced to go, the resources remain undeveloped and the world goes short. In the case of manufactures on the other hand the people do not necessarily have to go to the industry; there is the alternative that the industry may come to the people. The actual course of events depends on circumstances. The advantage of one place over another for the industry may possibly be considerable, and it may be accordingly worth while for an employer to offer a substantial inducement to workmen to come to the most suitable place. But this is exceptional. In general the limit at which the cost of the inducement offsets the local advantages is not likely to be very high. Manufacturing industry can be carried on at almost any place to which the necessary materials can be brought and from which the finished product can be sent to market. Apart from these essential conditions, the further local requirements are for the most part easily satisfied. A suitable site is needed for the necessary buildings and fixed capital; there must be an adequate supply of labour, and for it there must be housing accommodation, and supplies of consumable commodities.

Manufacturing industry may be carried on either close to the places where necessary materials are produced or close to the consumers of the finished product, or at intermediate points. For example, threshing, being a process applied to wheat after severance, may be regarded as a manufacturing industry, and it is invariably performed close to the wheat-field. The baking of bread on the other hand is performed in the vicinity of the consumer. Milling may be performed at any convenient point between the threshing-machine and the bakery.

If a manufacturing industry involves the use of some bulky material which is costly to transport, the places in which it is established will tend to be so chosen that the distance to be travelled by this material from its place of production to its ultimate distribution will be kept as nearly as may be to a minimum If the bulky material is wholly

or partly destroyed in the process of manufacture, so that the finished product is much more transportable than the component materials, then the industry will tend to be established as near as possible to the place of production of the bulky material. This is one of the cases where the local advantages of a place for manufacture may be considerable. It is well illustrated by the use of fuel, which is completely consumed. It is economical to establish industries which consume coal in large quantities as near as possible to the mining areas.

Where the materials are not appreciably diminished in bulk or weight in the course of manufacture, there is no special advantage in placing the industry closer to any of the sources of materials than to the markets to which the finished product is to be sent. In that case the most suitable position will be one having convenient communications in all these directions. In some industries production is most economically carried on on a very large scale—the law of increasing returns remains in operation till the output of a single business is very large. If that is so, there must be relatively few separate centres at which the industry is carried on ; materials must be collected (possibly from great distances) at these centres, and distributed from them (again over great distances) to the markets of the world. This is particularly so with the making of iron and steel, and of the heavier iron and steel products.

Where the most economical industrial unit is comparatively small—where, that is, the limit at which the law of increasing returns ceases to be operative is low—there are still some advantages in concentration of many similar businesses at one place. Experienced workmen who are settled there can take employment in one business or another as required. The orders which one business is too busy to undertake can be passed on or sublet to another. And concentration helps the organization of marketing, both in the purchase of the materials and in the sale of the finished product. Innumerable examples could be cited of the concentration of many separate concerns, all engaged in the same industry, in one place.

Nevertheless concentration of this kind, frequent as it is, must on the whole be regarded as exceptional. Decentralization is more usual, where the law of increasing returns does not lead to the concentration of a single vast business. Decentralization makes possible the very real advantage of proximity to the consumer whose tastes have to be suited, and, where the sources of supply of materials are

scattered, concentration involves unnecessary cost of transport.

Decentralization of course can only be relative. The question is whether the manufacturing centre supplies a larger or a smaller area ; a centre it must always be.

From the consideration of manufacturing centres we pass to marketing centres. The goods produced in any area not for local consumption but for sale elsewhere, are produced with a view to the markets that can be reached by the available means of communication. Dealers, as we saw in Chapter III, order them in anticipation of demand and hold them in stock at convenient interposts.

How will these interposts be chosen ? Internal lines of communication connect up the actual places of production, first by road to local centres, then by rail or waterway to bigger and bigger centres till at last the goods converge at the point from which the main lines of communication issue to the outside world. These lines are relatively few. In fact the transport system is governed throughout by the advantages of transportation *on a large scale.* This concentration is designed to fill frequent and regular trains or ships as nearly as possible to the limit of their capacity. Only so can the full benefit be derived from the heavy capital expenditure and overhead charges inseparable from an effective modern transport system.

The dealer will transport his goods up to the point at which the concentrating process is completed. But to reach the markets, the concentration has ultimately to be reversed ; the goods must be dispersed. Before he begins the dispersing stage he will wait to see the state of markets. The special characteristic of an interpost, or place at which merchants' stocks are concentrated, is that it is a point at which dispersal to markets begins and at which therefore the decision can be taken as to the destination of the goods. Like the concentration, the dispersal proceeds by stages. Each successive centre at which a fresh choice of destination is made plays the part of a subordinate interpost, till the chain ends in a shop, from which the consumers themselves choose their purchases.

Manufacturing processes which do not affect the transportability of the materials to which they are applied tend to be set up at these interposts. To stop the materials at an intermediate point would involve an unnecessary unloading and loading. If a place, not otherwise the most suitable as an interpost, has decisive advantages for manufacturing (if, for example, it contains the fittest labouring population,

or possesses some advantage of natural power production), it will tend to be used as an interpost, and it may be worth while to improve its communications at considerable cost, rather than establish an interpost elsewhere.

For raw materials the manufacturing centres are themselves for some purposes the consumers. Where several different materials are needed for a single manufactured product, the place of manufacture must be at some point where these materials can all be conveniently assembled. The main routes from the different sources of supply to any given group of consumers must converge at some point, but this point might be in the immediate vicinity of the consumers. If the manufacturing process is one which does not need to be carried on on a large scale, and which can therefore be decentralized, the materials can follow their natural route, and will only be brought together and manufactured at the last stage. But if manufacture on a large scale is required, a manufacturing centre may be established to serve a large number of consumers distributed over a wide area, and the materials may be diverted far from the direct route to the consumer.

Subject to the special exigencies of manufacture, the governing factor is always the local distribution of the consumers. And the consumers are the producers—and some others. The same lines of communication that collect goods from the producers serve to distribute goods to the consumers.

One large class of consumers will be the agricultural producers spread over the land. Their dispersion is a difficulty in the way of supplying them. They have to supplement the modest resources of village shops and itinerant traders by occasionally visiting neighbouring urban centres, or ordering goods from them by post. A mining population is somewhat less scattered, and enjoys better shopping facilities.

The manufacturing and, still more, the trading population on the other hand are, as we have seen, naturally concentrated. They grow up at the very points to which goods flow. A centre, once selected as a convenient interpost for the supply of the scattered consumers of a district, becomes itself for that very reason, an important group of consumers.

Moreover, side by side with the consumers, whether scattered or concentrated, there will be certain classes of producers to whom proximity to consumers is the principal consideration in the choice of locality. Among them are included those occupied in the most decentralized manu-

factures, and also "personal workers," whose production consists of services rendered, which are not embodied in any material commodity.

The urban centres have a higher proportion of these classes. To some personal workers concentration of consumers on a considerable scale is essential, e.g., for theatrical performers or university teachers. Personal workers, also, are employed in greater proportion by the rich than by the poor, and the richest classes, those who receive profits, tend to be concentrated in the towns.

The big profits accruing from a commercial centre thus add to its importance as a consuming centre. The rich men spend a part of their incomes on commodities for their own consumption. Part they spend on the services of personal workers, who in turn are consumers of commodities. Part on the other hand they invest, and their investments may not be local. Investment at a distance is a subject to which we shall return in the next chapter when we consider international markets.

In the last chapter it was pointed out that some of the biggest markets deal in commodities that can be standardized or sampled, and that the dealings need not be conducted in close proximity to the goods dealt in. Such markets, along with the financial markets, can be concentrated, without regard to the routes followed by the goods, in vast cities on sites chosen for the advantages of their communications with all the world. These cities may be almost negligible as centres of production of material commodities, and yet may be the greatest assemblages of consumers. They may not even be great interposts, so far as the physical transport and distribution of commodities are concerned, though in general the same advantages of communications that make them convenient as market centres will also attract the interpost business.

Advantages in production, transport and marketing are perpetually tending to distribute the population according to the principles described in this chapter, but, whenever these principles point to any serious *change*, they have to encounter a formidable obstacle in the inertia of the population. This inertia is partly psychological. People are unwilling to change their surroundings and their habits, even for the sake of a substantial improvement in their material circumstances. And those who would be willing may not easily get to learn of the opportunity for improvement, or, when informed of it, may not easily be persuaded that it is real and practicable.

But there are also physical obstacles. When for any reason the economic conditions point to a migration of population into a particular locality, the migration cannot actually take place till the requisite housing accommodation has been provided for the people, and the requisite fixed capital for the work upon which they are to be employed But the construction work itself requires the presence of labour. In the preliminary stages workmen may have to be brought to the place in excess of the numbers that can be comfortably accommodated, and their reluctance to come under such conditions may materially retard progress.

Inertia tends to keep centres of population where they are, growing with the natural increase of population. Changes such as those referred to earlier in this chapter, are perpetually affecting relative local advantages. In the first instance it is for the promoters of new enterprises to take advantage of them, but they can only do so in so far as they can find the necessary labour. This labour may be provided either by a large number of settlers, each working on his own account, or by the immigration of workmen to enter employment. In any case it has to come from countries already peopled. A reluctance of people to migrate makes itself manifest in inequalities in the remuneration of human effort. The same man with the same exertion can earn a greater supply of products if he migrates to a place where the labour supply is less in proportion to the local advantages than where he is

CHAPTER X

GEOGRAPHY AND INTERPOSTS

IN the last chapter we considered the effect of economic circumstances upon the distribution of the human race over the surface of the earth. We found in particular a tendency for centres of population to form at places suitable for interposts, and we showed that at such places manufacturing business tends to be concentrated as well as commercial business.

The choice of places for interposts is governed by the means of communication. Communications depend on geographical features, modified in some degree by human agency. Suppose a level plain, free from any considerable natural obstacles, and cultivated by a population dispersed over it. An indefinite variety of different road systems would be possible. But that does not mean that their relative merits could ever be a matter of abstract geometry. In the first place geographical features could hardly be absolutely negligible. There would probably be slight undulations, and probably also watercourses. Secondly it is unlikely that the inhabitants would be spread quite evenly over the area. Some portions would be cultivated more intensively than others, some would be more productive. Some sites would be more suitable for dwelling-houses than others. Any point at which there is a concentration of population tends to have better communications made for it and thereupon a further concentration is encouraged.

Finally, in any case, the communication system within such an area cannot but be influenced by the position of the communications with other areas, separated from it either by the sea or by inland features such as rivers, mountains, forests, swamps or deserts. From the point at which a way across any such obstacle reaches the area people will need communications in all directions. For along such ways will come and go the long-distance traffic with the neigh-

bouring areas, and with remote places. Roads or railways from within the area must converge on such a point in order to collect exports and to disseminate imports, and there an interpost will be situated.

An area of any size free from obstacles is an exception In general the lines of communication have to be accommodated to a variety of natural features. Swamps and deserts, being themselves unfit for habitation, are mere barriers, and the only question is how to cross over them. Mountains and hills on the other hand present several different problems. Very high or rugged chains are mere barriers. Hills over which people can pass without difficulty may, nevertheless, be unfavourable for production or settlement. Yet those which are favourable for settlement are often considerable enough to affect materially the choice of route. This is particularly so with railways, for which steep gradients are a great disadvantage, and quite moderate irregularities of surface appreciably increase the engineering difficulties.

Main roads and railways tend to run along valleys; occasionally also along ridges, but a level ridge, of which the approaches are not too steep, is a rarity. Where there is a mountain barrier, the roads along the upper valleys are cut short by the barrier and are for the most part of purely local importance. As the valleys converge, the roads converge. At the mouth of any valley where the convergence brings together a considerable volume of traffic, there will be an interpost. Among the valleys there will here and there be one at the head of which a mountain pass gives access across the barrier to a neighbouring region. At the point at which the road descending from a pass gets free from the highlands, so that communications can branch out in various directions, there will be an important interpost. This is a particular case of the general principle that there will be an interpost at the point at which a route completes the transit of a natural obstacle. It is equally true where the obstacle is a river, though as it is possible to build many bridges over a river, the concentration at any one of them is not necessarily considerable.

A river differs however from a mountain range in that, although it is a barrier, it is also at the same time itself a means of communication. Before the invention of railways rivers were the most efficient form of inland transport. For heavy loads or for long distances road transport was far more costly, and often it was little, if at all, more expeditious. Even in competition with railways, the great rivers and

canals retain their advantages for heavy loads for which speed is of no consequence.

Regarded as an obstacle with a limited number of crossings a river gives rise only to interposts of local and subsidiary importance. Regarded as a means of communication it may feed the greatest of interposts. The great river interposts have no doubt been founded on the pre-railway advantages of river transport. But these advantages, though in themselves diminished, have been supplemented by the suitability of river valleys as railway routes.

The culminating position for a river interpost is at the mouth of the river, or rather at the head of the estuary, the highest point to which sea-going ships can regularly and conveniently come. Sometimes (as in the case of the Danube) conditions at that point are such as to make the establishment of a city and port impossible. But that is exceptional, and the association of great interposts with great estuaries all over the world is so general that it would be superfluous to name instances. A great natural harbour without adequate inland communications is useless except as a port of call or shelter.

The sea is the greatest of all barriers, and yet the greatest of all roads. It is the road which gives access to world markets. Once free of the tangle of inland ways, and stowed on board an ocean-going ship, goods are within reach of every part of the world.

Every seaport is an interpost. It is an intersection of the sea routes with one another and with the land routes. Some seaports are chiefly important as ports of call. If a long sea route, connecting regions doing a considerable volume of trade with one another passes close to land at a certain point, and if there is a suitable position for a harbour in the neighbourhood, a port of call will be established, at which ships can put in not only to replenish supplies but to receive fresh directions, if need be, as to their ultimate destination. This opportunity of making a choice of destination is of the essence of an interpost, and the great ports of call rank high among interposts. Ports of call tend to be established at the ends of peninsulas, or in narrow straits. Obvious examples are Singapore, Colombo, Aden, Port Said, Constantinople, Brindisi. In ancient times, when ships never travelled far from land, islands which afforded convenient stages between one mainland and another were often used as ports of call. Rhodes may be mentioned as an illustration.

Apart from the special case of ports of call, the standing

of a seaport as an interpost depends upon its landward communications. To favour its development, not only must the communications themselves be efficient, but the regions to which they penetrate must be productive, and their production must be such as requires a division of labour and an exchange with oversea places. The oversea places with which exchange is to be effected must be within marketable reach, at a distance to compete with those (if any) in a position to do business through an alternative interpost.

If these conditions are fulfilled, a position at the head of a big gulf or arm of the sea is particularly suitable for an interpost. At such a point seagoing ships find themselves already far inland when they unload; the landward communications extend not only inward but also on either side. A notable example is that of Venice. Primarily Venice was the interpost for the rich and populous valley of the Po. It was the channel through which civilization flowed from the Byzantine Empire and the Levant, first into Italy and then into feudal Europe. But, besides the Po Valley, trade routes radiated from it to the East and to the North. To the East they led by way of Istria to Laibach and the Valley of the Save and so into the Danube basin. To the North they led over the Brenner, the one commercially practicable pass across the Alps, to Innsbruck, Augsburg and Germany. It seems surprising that one of the principal Venetian trade routes should have involved the passage of the Alps. But the Venetian trade was *long-distance* trade. The commodities that were carried up the Adriatic had often not merely travelled from the Black Sea or Syria, but had reached the Levantine interposts from Arabia, India or even China. If they could stand the cost of so much carriage, they could stand a little more.

Genoa likewise throve on a re-entrant coast and a rich hinterland. To the north, by a gap in the Appenines, it communicated with Alessandria and the Po Valley. To the south-east it was within easy reach of Florence and Rome. To the west it had access to the French market, the richest perhaps, next to the Italian, in Mediæval Europe.

The same principle is also illustrated by the commercial history of Syria. At the Eastern end of the Mediterranean is a perfect galaxy of historic interposts. Tyre and Sidon, Damascus and Antioch, Laodicea and Acre, Aleppo and Beyrout succeeded one after another to the rich heritage of the Levantine trade routes, till the Turks brought stagnation and decay. From before the beginning of history down to the culmination of the Roman Empire the surrounding

countries of Mesopotamia, Armenia and Asia Minor, teemed with a flourishing population. In addition some of the principal trade routes from the countries further East debouched in Syria. Much of the Indian trade came up the Persian Gulf and through Mesopotamia. Overland trade from China penetrated to Europe by way of Samarkand and across Persia.

In modern Europe the commercial centre of gravity has moved northwards. Europe is much better adapted to carry on its sea-borne trade from the north than from the south. The region most favourable to settlement and economic development, in which at the present day 150 millions of people enjoy the advantages of a temperate climate, a moderate rainfall, great natural resources, and communications free from serious physical obstructions, is that which extends from the Bay of Biscay to the Vistula. Between this region and the peninsulas which project into the Mediterranean formidable mountain barriers intervene. Only the peculiar importance of the Mediterranean as giving access to the Eastern trade routes, and to the still living tradition of civilization at Constantinople, could reconcile the traders of the Middle Ages to approaching the vital central European market across this barrier.

Those who traded later on by the great ocean routes had no need to enter the Mediterranean except for direct trade with its coasts. On the north side of Europe they found a comparatively level country intersected by a series of great navigable rivers, which facilitated access throughout its breadth.

The North Sea is an inlet approximately rectangular in shape and bounded by land on three sides, the east, west and south. But the continuity of these coasts is broken by the entrance to the Baltic in the middle of the east side, and by the entrance to the Channel in the south-west corner. Before ocean-borne trade began, the characteristic of the North Sea as an inlet had little effect upon the development of its interposts. They came into being it is true, on the southern side of the rectangle, but that was because the great navigable rivers which communicate with the interior flow into the sea there. The land to the east and west was in too primitive a condition to provide much trade. England's function in international trade hardly extended beyond the production of wool for use in the Flemish textile industry.

When the North Sea interposts began to gain a growing importance from ocean-borne trade, the seafaring and

mercantile aptitudes of the inhabitants, particularly the English and the Dutch, found new scope. In the 17th and 18th centuries the business came into the hands particularly of three great rival interposts, Hamburg, Amsterdam and London, strung out in a row along the southern side of the rectangle. At first Amsterdam, with the advantage of the Rhine traffic, took the lead.[1] The rivalry was settled by political rather than economic causes. Holland was too small and, with its land frontier, too vulnerable, to retain the position of the greatest maritime and colonial power. Hamburg was no more than a city state. Both yielded place to London. As English mercantile business grew, the English market itself acquired greater importance. England has the same climatic and physical characteristics as the most favoured part of Europe, and in addition has the advantage for the purposes of communication of a long and irregular coast line. No point of Great Britain is more than 60 miles from the nearest sea.

As soon as the western side of the North Sea rectangle became a rich market, the position of London in the south-west corner was further strengthened. Cargoes from over-seas came first to London, where they could either be landed or sent on to the Continent, as the state of markets might require. The English market was to London what the basin of the Po had been to Venice.

English prosperity was already rapidly growing, when the industrial revolution brought a new factor into the situation. The use of machinery, of power and of factory organization had already begun in England, when the outbreak of the wars which followed the French Revolution violently interrupted economic development on the Continent. For a generation England, alone exempt from invasion, had something like a monopoly of the new methods in Europe

We have seen in the last chapter how manufactures as well as commerce are attracted to the great interposts. London became the distributing centre both for the colonial produce re-exported to the Continent, and for British manufactures exported all over the world.

Another circumstance came in to increase the British pre-eminence. The industrial revolution gave a new importance to coal-fields. Coal was required both as a source of power for manufacture and for transport and as a means for

[1] Amsterdam is an example of a financial centre at a little distance from the main part of the actual traffic from which its business comes. It is 40 miles or so from Rotterdam, the Rhine port.

the production of iron and steel. The cost of transport of coal is heavy in proportion to its value and, in order to get the benefit of cheap fuel, industries tend to be established in the vicinity of the coal-fields. The British coal-fields are the biggest in Europe, and this alone would have sufficed to give British manufactures a high position.

In the course of the 19th century the other great coal-fields of Europe were developed. Those of the Ruhr Valley, Belgium and North-Eastern France, stretching across the Rhine within a moderate distance of its mouth, became the foundation of a vast industrial development, surpassing in some directions that of Great Britain. But the English mercantile pre-eminence remained, and still more the financial pre-eminence that had beeen built up on it.

In the 20th century not only is London the principal interpost of the North Sea and therefore of Europe, but the English market itself is the richest served by this interpost. The present position of London, however, depends on many other factors than geographical position. If the sole question were that of convenience in handling goods, a port on the Continent, such as Rotterdam or Antwerp, would probably serve better. Goods brought with a view to subsequent re-export could thence be sent either by sea to England or the Baltic or by an uninterrupted land journey to the interior markets. From London they have to go to these latter by a mixed sea and land journey, involving reloading. But the markets of London (both commodity markets and financial) are so firmly established that considerations of this kind cannot affect them. With modern improvements in communication the physical proximity of the goods dealt in has become less necessary than ever to a market. A cargo may be bought and sold a dozen times while it is at sea and, with the use of wireless, may be diverted to a new destination without touching port.

Cargoes do, however, tend to be landed in England pending disposal if, as is so often the case, they are financed by bills on London. The bills are commonly secured by the bills of lading of the goods, and, when that is so, the goods must come to the same place as the bills of lading.[1]

In the New World a striking example of the advantages of a position at the head of an arm of the sea is supplied by Buenos Ayres. The estuary of the River Plate penetrates some hundreds of miles into the most productive region of

[1] The bills of lading may be handed over and the goods released either on the acceptance of the bills or on actual payment, according to the agreement between the trader and the banker.

temperate South America. Buenos Ayres situated on the southern shore, a little short of the head of the estuary, has the advantages of an inland position and of a port The effects are seen in the rapid growth of the city, and in the great railway system of which it is the centre.

Another example is to be seen in Chicago. The Great Lakes of North America are like seas for the purposes of navigation. To Chicago Lake Michigan is what the Adriatic was to Venice. But no obstacle is interposed between Chicago and the Mississippi Valley like the Alps between Venice and Germany. On the other hand, important as the traffic of the Great Lakes is, there is not uninterrupted communication between Chicago and the ocean.

The pre-eminence of New York illustrates somewhat different principles. In the first place New York is an example of the common case of an interpost at the mouth of a navigable river. But that by itself is only a part of the story. The original American Colonies occupied a narrow strip of territory between the Appalachian Mountains and the Atlantic Coast. The mountains were not an insurmountable but yet a substantial obstacle to intercourse with the interior, but at the northern extremity they gradually flattened out. Baltimore, Philadelphia and New York have successively better communications with the West. In the early 19th century New York gained the advantage of direct canal communication between the Hudson and Lake Erie. Its relative advantages were subsequently diminished, but by no means ended, by the provision of railway communication from Philadelphia and Baltimore across the northern spurs of the mountains.

The three ports together illustrate a tendency for interposts to grow up at the point where the lines of communication with a large productive area have to circumvent a barrier. The case is analogous to that of a port of call at the end of a peninsula, where several different routes touch one another. It also has some resemblance to the position of Vienna, at the north-eastern tip of the Alps. But New York, Philadelphia and Baltimore have the advantage of being ports marking the change from land to sea transport and vice versa.

CHAPTER XI

INTERNATIONAL MARKETS

UP to this point we have left the State and its functions in the background. Nor shall we undertake any systematic examination of its economic relations till the next chapter. In the present chapter, however, we shall have to take some account of the fact that human communities trading with one another may be under different sovereignties.

Different sovereignties imply, among other things, distinct systems of law, distinct systems of taxation, and distinct currencies.

In Chapter VII the functions of banks in supplying the means of payment and in clearing debts were explained. And what was said there applies to any transactions in which one and the same currency is used. Suppose that there are two trading centres at a distance from one another, but within the jurisdiction of a single sovereignty, and using one currency. Traders in each centre are becoming indebted to traders in the other. They can draw upon their banking accounts to make payment. By this process the indebtedness is transferred to the shoulders of the banks. The banks in each centre become the possessors of cheques, bills or other documents constituting them the creditors of the banks in the other. These liabilities can be " cleared " or set off against one another. If the clearing is carried out to its ultimate limit, all that remains to be done is for the clearing house in one centre to pay a net balance to the clearing house in the other. This net balance can be paid in legal-tender money If there is a central bank at the financial centre of the country, at which all the clearing banks concerned keep accounts, the balance can be settled by a cheque upon it. In that case the settlement of liabilities is completed without the physical transmission of any money at all Money will be sent from place to place (usually from the central bank to the other banks or back from them to the central bank) but that will not be for clearing purposes ; it will be to enable the banks

to meet their customers' requirements in respect of payments which are more conveniently made in money than in credit.

Where branch-banking is highly developed, the clearing system is still further facilitated, for a bank can readily adjust accounts between two of its own customers in different places without resort to the clearing house.

When it comes to settling the mutual liabilities of people who are not merely in different places but in different countries, using different currencies, there is a complication. In order that debts expressed in one currency unit may be set off against those expressed in the other, the value of either unit in the other must somehow be determined. There must in fact be a *market* in the currencies themselves.

This is what is called the foreign exchange market. In it dealers offer to buy and sell credits payable in foreign places, and reckoned therefore in foreign currencies. Such credits will ordinarily be debts due from bankers, which can either be used themselves as means of payment, or can be turned into money, at the will of the creditor.

The stock-in-trade of a dealer in the foreign exchange market is composed of these credits. To him, as to other dealers, the state of his stock-in trade will be a sign of the appropriateness of his prices to the state of the market. If he sells foreign credits too cheap, that is to say, asks too small a sum for them in the currency of his own country, his stock of foreign credits will diminish, and to maintain it he must ask a higher price. Similarly if he fixes the price of foreign currencies too high, his stock of foreign credits will increase to an inconvenient extent, and his cash balances in his own country will be depleted. He aims at finding an equilibrium price, by which his stock of credits both at home and abroad can be kept approximately constant. As in other markets, the price tends to be that at which supply and demand are equal. It may be pointed out that the *demand* in either of two countries for the currency of the other is itself the *supply* in the latter of the currency of the former.

In any country foreign currencies are valued as being the means of paying for foreign products. If the prices of foreign currencies are raised, then the cost of the foreign products in terms of the currency of the purchaser's country is raised. Thereby purchases are discouraged. At the same time, the cost of the country's products to foreign purchasers being diminished, its sales are increased. The reduction of purchases of foreign products diminishes the demand for

foreign currencies, and the increase of sales abroad creates an additional supply of them. Thus, if the dealers in foreign exchange find their foreign balances are being depleted, they can restore equilibrium by raising the prices quoted for foreign currencies. Similarly, if their foreign balances are becoming excessive, they can restore equilibrium by reducing the prices quoted.

The equilibrium is ultimately an equilibrium in the purchase and sale of *products* between the countries concerned. There are, it is true, liabilities to be met which do not arise from the purchase and sale of products. In particular there are payments of sums which are being invested in one country by people in another, and there are sums due by way of profit or interest to those who live in one country but who have capital or business in the other.[1]

To secure equilibrium, the products exported and imported must not be equal but the difference between them must be equal to the net balance of other liabilities to be met. When this is so, exports and imports may be said to *balance*

Foreign products, at any rate those products of foreign countries which are suitable for exportation, have an international price. That does not mean that they have absolutely the same price in two different countries, but that the prices in different countries are related together. The merchant in one country who deals in a product which might be imported from the other has the choice of either importing it or buying it at home, and under the equalizing influence of the market the price will tend to be the same for a commodity of the same quality from whichever source obtained. Where the commodity is such that it can be exported over great distances, it will have a world market and a world price. This is especially so with the great staple foods and raw materials, which are in demand everywhere, and which can be standardized in quality. Finished products often have to be adapted to the idiosyncrasies of the particular people for whom they are destined, and once completed have a price only in that market.

The price will in general be higher in the importing than in the exporting country, because the cost of transport between the two represents a clear addition to the cost of production to a merchant in the former That is why the world price is not a uniform price. The prices at all the places through which the commodity moves from the sources

[1] It will be recollected that we are using the term "products" to include *services rendered*, e.g., by ships which carry goods from one country to another. (See pp. 10-11 and 27).

of supply to the consumer are determined in a single world market, and the difference between the price in any exporting country and that in any importing country which is supplied from it approximates to the cost of transport between them.

Now these prices will be calculated each in the currency of the country concerned, and the comparison between them can only be made on the basis of the rates of exchange prevailing in the foreign exchange market. If the exchange market is in equilibrium, then prices must conform to this test, and exports and imports must balance. If exports and imports do not balance, the dealers in foreign exchange will raise the price of the currency of that country which has been exporting too much. Its products will thereupon become dearer in terms of foreign currencies, and foreign products will become cheaper in terms of its currency. Its exports will become less profitable and its imports more profitable. The loss or gain may accrue to either the producers or the merchants. However the loss or gain be shared, the profitable import trade will be stimulated, and the unprofitable export trade will be checked, till exports and imports balance again. In the process of adjustment the relations between prices at different places may be disturbed. But if markets are working normally, the disturbance is temporary.

The variations in price of the same product in different places exist also within the limits of one country with a single currency. For goods of small bulk and weight in proportion to their value, the gradations of price may be so slight as to be almost negligible. But for some, such as coal, bricks or timber, the freight forms a very substantial proportion of the wholesale price at a distance from the places of production. In any bargain of which such a commodity is the subject, the *place* at which it is to be delivered is an essential factor.

So long as the bargains are all made in one market, the existence of these variations does not detract from the unity of the market price, and similar variations in the prices of exportable goods do not invalidate the conceptions of a world market and a world price.

Under the equalizing influence of world markets the prices in any country of what may be called foreign trade products, that is, those suitable for export and import, will be the equivalents (subject to the proper local variations) of those in any other country converted at the rate of exchange prevailing between their respective currencies. That means that the rate of exchange simply measures

the proportion of the prices of foreign trade commodities in the one country to those of the same commodities in the other. In so far as those commodities can be taken as a test of purchasing power, the rate of exchange measures the relative purchasing power of the two currencies.

In the particular case where two countries both have a gold standard, where, that is to say, bank credits are convertible into gold and gold into bank credits in each country at a fixed rate, it is possible to buy gold for currency in either country, and to send the gold to the other and there turn it into currency again. The possibility of such dealings ensures the maintenance of the rate of exchange within a fraction of the ratio of the amounts of gold into which the two currency units are respectively convertible.[1] Whenever the balance of exports and imports is upset, the foreign exchange dealers cannot raise or lower the rate of exchange beyond this limit, and as soon as the limit is reached gold begins to pass from one country to the other. That means that foreign trade products at world prices are made unduly cheap to consumers in the country which is losing gold, owing to the limitation of the rate of exchange. They buy too much. The gold serves the purpose of paying for the uncovered balance of goods, and of replenishing the foreign exchange dealers' supplies of the currency of the country which exports these goods. No country can afford to go on losing gold indefinitely. The steps that require to be taken to check the loss of gold belong to the theory of credit and cannot be dealt with here.[2] It is enough to say that in the end the purchasing power of the currency unit (or, inversely, the price level) must be so influenced mainly through a contraction of credit that the prices of foreign trade products are once again in harmony with prices generally and with the supply of currency.

To return to the general case, whether different currencies are or are not linked together by a metallic standard or any other method of regulating the foreign exchanges, the relation between the price levels and the rate of exchange must hold, so long as the world markets in commodities and in foreign exchange are effective.

The prices of foreign trade products and home trade products in any country are not independent of one another.

[1] The fraction would not ordinarily exceed so much as is necessary to cover the cost of transporting gold from one country to the other, together with such difference as the banks make between their buying and selling prices of gold.

[2] See my "Currency and Credit," particularly Chapters VI and VIII.

We have defined the expression foreign trade products to comprise not only things actually exported or imported, but those *suitable* for export or import. Consequently all the similar things produced and consumed at home are included, and home trade products are limited to those which do not enter directly into competition in the export or import markets at all. That may be because transportation is physically impossible, or because the cost of transportation is so high relatively to the value of the product as to be practically prohibitive, or because the product is suited solely to the tastes, habits or circumstances of the people of the country where it is produced.

All the products which are consumed in a country are in competition with one another in at least two ways. In the first place consumers as a body have to choose in what way they shall spend their incomes The more they spend on one class of products the less they can spend on others, and they must therefore exercise preferences between them.

Secondly there is a tendency for the productive resources of the country, land, capital and labour, to be directed to the most profitable purposes. The equalizing influence of markets ultimately tends to equalize not only prices, interest, wages and salaries, but also relative profits. Ultimately, therefore, prices tend to be equal to cost of production, *plus* normal profits

A study of purely temporary disturbances of the equilibrium between prices of foreign and home trade products would lead us far afield in monetary theory. We will therefore confine ourselves to the more permanent or long-period influences.

In Chapter IX we saw that while population tends to migrate to the places of greatest local advantage, the tendency only works tardily and incompletely, and that the imperfection of the distribution of population makes itself apparent in an inequality of remuneration for the same amount of human effort in different places. We will now proceed to see more exactly how this inequality is brought about, and what its consequences are.

In the first instance we will simplify the problem by taking a new country with agricultural resources and by disregarding the process of investment of fresh capital in the country. We will assume that the means of communication and transport have already been installed, and that the further capital expenditure immediately required in the area ready for settlement is small.

Settlers come, but not in sufficient numbers to cultivate

the land extensively and intensively up to the standard of the fully developed countries from which they have come. Some land, which could send produce to market at a smaller total cost of effort (including transport) than that on the margin of cultivation in old countries, is left uncultivated.

The owners of this land are losing the whole of the economic rent which, if cultivated, it would yield them. If they could secure labour at the same money cost as in an old country, they would do so, and would escape the loss. If their land is kept out of cultivation, that must be because the cost of labour is high enough to make cultivation unprofitable. If the labour market works effectively, all labour in the country will be correspondingly costly.

This is not limited to wage-paid labour. A new country is often developed by settlers who occupy and cultivate their own holdings with the help of their families, but with little or no hired labour. It still remains true that the labour of the settlers is applied to the pick of the land, and the pecuniary yield to them is high in proportion to the productivity of their labour. The agency disposing of the land (which may be a railway company or a land development company, but is often the Government or some public authority) will offer land to settlers at a low rent in order to hasten development. This is simply another way of giving the settlers a high remuneration for their labour.

The high rate of remuneration not only determines a relatively restricted margin of cultivation, beyond which land is left undeveloped, but it limits the intensive cultivation of the land which is within the margin.

High wages also discourage all forms of production other than those for which the land is especially adapted. Manufactures are imported from old countries, where wages are lower, even though they could be produced in the new country with less total effort. Materials may be sent thousands of miles from a new country to an old, and manufactures made of the same materials may be sent back from the old to the new, even though the old country may have no advantages in the manufacturing process other than low money wages.

Importable products are thus obtained at world prices. So also, of course, are those things which are being produced for export, so far as they are retained for home consumption.[1] It is possible that they are not so retained

[1] Strictly speaking of course the importable products are obtained at world prices, *plus* cost of transport, and exportable at world prices, *minus* cost of transport. If the staple export products are transportable

at all. The special local advantages of the country may be almost exclusively for the production of some material for manufacture, the whole of which is exported, and even food may be imported. It is more probable, however, that the exports include some natural products, such as food, which are also in demand in the home market.

Thus, in the spending of their high earnings, the inhabitants of the new country have the advantage of getting foreign trade products of all classes at world prices. But the case of home trade products is different. The labour applied to them must be attracted away from the profitable production of exportable goods, and must be paid at the same high level as those who are so engaged. Internal transport, domestic service, laundry work, baking, are obvious examples. The cost of building is another, composed, as it is, partly of labour, partly of bulky materials which can only be imported, if at all, at a high cost. The profits and expenses of internal trade, including retail trade, will also be high, and there may arise the paradoxical result that goods of the kinds that are being exported from the new country are sold there at a higher retail price than in the countries by which they are imported. The retail price of bread is higher in New York than in London.

When allowance is made for the high cost of home trade products, the purchasing power of wages in the new country, though on the whole higher than in the old, is not in proportion to their money value.

The comparison here made between wages in a new country and an old must of course be based upon the rate of exchange between them. The whole theory can in fact be restated in terms of the balance of exports and imports. The new country has special local advantages, enabling it to produce goods for export at a low cost of effort. It may be so favoured by nature that it can produce practically all it needs with no greater effort than other countries, and it is thus in a position to export without importing, so long as the value of its currency in the foreign exchange market is no more than in proportion to the amount of human effort it will buy. But this is a condition that cannot hold. The foreign exchange market can only attain equilibrium if the exchange value of the new country's currency is raised relatively to its internal value till its exports

at very small cost in proportion to value (like gold) and if the country is very inaccessible, the cost of transport may raise the prices of imported products very high indeed.

and imports balance. In the process the real remuneration of effort in the new country is correspondingly raised.

The high cost of labour enters into the home trade products as well as into those destined for export. But the latter are relatively cheap, because the local advantages of the country enable them to be produced and sold at the world price. With the home trade products it is otherwise, and the effect of their relative dearness is to diminish the demand for them in comparison with the demand for other things. Thus one effect of the high cost of labour is to divert productive effort from those things which cannot be exported to those which can, though the diversion is naturally less complete in the case of those things which cannot be replaced by imports.

If the new country is being supplied with capital by investors from the old, the disparity in standards of remuneration is increased. At this point it will be desirable to show in what the supply of capital from one country to another consists. We may suppose a promoter raising funds from investors in one country with a view to spending them on capital works of some kind in another. The two countries may conveniently be distinguished as the lending and the borrowing country, though, of course, the investment may be an issue of shares, and not a borrowing operation properly so called. For the construction of the works a certain amount of material and of manufactured goods will probably be required, and a part of these commodities may be imported into the borrowing country. These imports can be paid for through the foreign exchange market from the funds subscribed in the investing country. But the greater part of the cost of the works will probably take the form of labour, and this labour and a part of the requisite materials must be obtained within the borrowing country itself. For this purpose the funds subscribed in the lending country must be exchanged for credits in the borrowing country, through the foreign exchange market. The exchange dealers will find themselves receiving more money than they need in the lending country and paying away more than they can spare in the borrowing country. They will defend themselves by adjusting the rate of exchange against the former and in favour of the latter. The usual reactions will follow. Exports from the lending country will be stimulated, and imports into it will be checked. A new balance will be secured, when exports have so far increased and imports diminished that the funds to be remitted from

one country to the other are being sent in the form of goods.

The goods sent are not for direct use in the construction of the new capital works (those so destined we have already dealt with). Their function is to set free, for employment on the capital works, productive power that would otherwise be applied to supplying goods for consumption. The goods imported for this purpose are closely analogous to those imported into a new country, which enable effort to be concentrated on those forms of production for export which make the best use of the country's local advantages. Here, as in that case, the effect of the proper adjustment in the foreign exchange market is to raise the remuneration of labour. As new countries are themselves the greatest importers of capital, the high cost of labour, which in any case prevails in them, is thereby accentuated.

The capital-exporting country has to suffer a reduction in the remuneration of labour. Investible funds which might have been spent in the country are not so spent, and the labour and productive power which would have been employed are set free. The expenditure so diverted comes into the foreign exchange market, and room must be made for it by a stimulus to exports and a check to imports. That means either that the exchange value of the currency falls or that credit is so contracted as to lower wages and internal prices. In either case productive power is attracted to foreign trade commodities by a lowering of wages and costs as reckoned in foreign currencies.

This process of adjustment is not as a rule to be seen as an isolated phenomenon. The export of capital grows up gradually and production grows up with it. The export of capital fluctuates, but that is often merely an accompaniment of fluctuation in production itself, so that very little adjustment is necessary to accommodate the balance of trade to the balance of payments.

The disparity in the remuneration of human effort, though it comes out clearly in the contrast between a new country and an old, is by no means confined to that case. The disparity exists among old and fully developed countries, and between one part of a country and another. In a sense it is attributable to a maldistribution of population; that is to say, the disparity could be corrected by a sufficient flow of population from the places of lower to those of higher remuneration. But that does not mean that the disparity is *caused* by the maldistribution. For the maldistribution is relative to the local advantages, and the cause may be

found in some modification of these local advantages, which makes the pre-existing distribution of population less suitable.

In the last chapter we summarized the various ways in which local advantages of new land may be increased, and the land brought within the margin of cultivation. In addition to the effects of the growth of population, there were there enumerated the exploration of new productive regions, the discovery of new uses for natural products already known to be obtainable, and improvements in the methods of transportation. These causes affect old countries as well as new. Even the first must be regarded as including the discovery of minerals previously unknown in the midst of a country long developed and civilized. The second and the third may well produce as profound effects in an old country as in a new.

But over against these and similar influences which may increase local advantages, we must set those which may diminish them. The position of a country which is dependent on international markets is in a certain degree precarious. It may be injured for example by an interruption of communications with a market, by a deterioration of the market itself, or by the growth of competitors. The interruption of communications is not likely to occur on an important scale except as the result of some political event such as a war, a revolution, or the imposition of a prohibitive tariff. The deterioration of the market may arise from a change in tastes or habits, or from the impoverishment of the consumers. I do not propose here to pursue the question of that general expansion and contraction of effective demand, which we associate with the trade cycle. Apart from that the impoverishment of the consumers on such a scale as seriously to affect the prosperity of the producers is exceptional. Either the impoverishment must be very widespread, or the demand for the product in question must be very local.

The most noteworthy cause of a diminution of local advantages is the growth of competitors. This may arise from a variety of causes. Whenever the local advantages of one region are increased, owing to some natural product obtainable from it being made available in a market, the local advantages of regions from which the same or competing products have previously been obtained are diminished. When the agricultural resources of North and South America were made available in Europe by the development of railway and steamship communications, European

agriculture was threatened with depression. The development of German coal and iron resources in the period preceding 1914 adversely affected the prosperity of the British producers.[1] Innumerable examples on a smaller scale could be cited.

The growth of competition may be due not to a new discovery of natural resources but to the invention of a new process of manufacture. The new process may not suit the circumstances and the aptitudes of those people by whom the commodity concerned was previously produced.

The same effect may be brought about, without any new discovery at all, simply by the improved efficiency of competitors previously ill-organized or ill-trained. An important special case is where a manufacturing industry becomes concentrated in one place, or a limited number of places, in order to secure decisive economies from production on a large scale. (See above, p. 88.) Small competitors outside the privileged circle of large producers will probably be driven completely out of business.

The result of the division of labour is that communities, like individuals, specialize. In any region the fixed capital, the training of the population, the means of communication are all planned with a view not merely to supplying local needs but to producing goods for sale in distant markets. The remuneration of human effort, the economic rent of land, the yield of capital, all alike depend upon production for export being successfully maintained. Let the export trade deteriorate, and productive resources have to be transferred to less favourable openings.

The first symptom of decline may be either a falling off in sales in the export markets, or a fall of price imposed upon the markets by new competitors. In view of the anxiety of producers to maintain output, the falling off of sales will itself very soon be transformed into a fall of price.

The fall of price will have two immediate consequences, first a reduction in the producers' profits and secondly an interruption of equilibrium in the foreign exchange market. The reduction in producers' profits will affect the "marginal" businesses. Sooner or later it will bring some of them to an end, and it will also discourage the entry of new capital into the trades affected. In this way there will ultimately be a diminution of output, which will aggravate the adverse

[1] The world demand for iron products was expanding so rapidly that the prosperity of the British producers suffered only relatively, not absolutely.

effect of the fall of price upon the balance of exports and imports.

This balance must be restored, and with it equilibrium in the foreign exchange market, in the manner already described. The remuneration of human effort reckoned in world prices, must be so diminished as to increase exports and curtail imports. One consequence of this will be that home trade products will become cheaper relatively to foreign trade products. The demand for them will be in a greater or less degree stimulated. This additional demand, together with the opportunities for producing at home goods formerly imported, will tend to provide employment for the labour displaced from the export industries. The time occupied by this transfer of labour and the distress involved in it will depend among other things upon the monetary policy adopted. If a gold standard is maintained, so that the prices of foreign trade products must remain fixed at world gold prices, then wages and the prices of home trade products must fall.[1] There will result all the phenomena of a trade depression. If, on the other hand, the country has an independent monetary standard (e.g., inconvertible paper money), the transition may be effected by a depreciation of the currency unit in relation to foreign trade products, while wages and the prices of home trade products remain nominally unchanged.

The loss to the community is not limited to the fall in wages. A part of the capital embarked in the declining export trade will probably be lost. The extent of the loss may vary within wide limits, as we showed in Chapter VIII. If the reduction in volume of business is great, and the trades affected are of a kind using much specialized fixed capital, which is not easily adapted to other uses, the loss of capital may be very serious.

Finally there is a loss in respect of the rent of land. In the case where the exportable staples adversely affected are agricultural, the land has to be turned to other uses which till then have been regarded as less profitable. On the other hand the fall in the cost of labour enables the margin of cultivation for other purposes to be extended, so that the rent of that land which in any case was never suitable for producing the exportable staples is actually increased.

Where the failing exports are manufactures, the direct loss of rent may be small. New and less profitable manufac-

[1] I assume that world gold prices remain stable during the period of transition.

tures may take the place of the old, and the landlords' loss may be confined to some diminution in the rents for factory sites and for the surrounding residential property. If, however, the labour displaced is directed not to new manufactures but to agriculture, more sweeping changes are involved. The population of the manufacturing centres will fall off, and there will be a serious fall in rents both for factories and for dwelling-houses. And the surplus population will gradually be dispersed over the land. In such a case the fall in wages and the rise in agricultural rents will both be exceptionally large.

We have already seen that, when population is sparse in proportion to natural resources, the landowners miss part of the economic rent that they might otherwise have obtained. Here we merely have the same principle in its application to the contrary circumstances. When population is congested, natural resources acquire, as it were, a scarcity value, which accrues to the landowners.

The increase in economic rent is real in terms of home trade products; the landlord gets a greater share of the yield of his own land, and those who work on it get less. On the other hand the landlord, like everyone else, has to pay relatively more for foreign trade products, and this is some set-off against his gain.

When we speak of a country being overcrowded, we mean overcrowded relatively to some standard of living. We mean that the number of people is so great, relatively to the material resources of the country in land and capital, that labour is cheap, and the market rate of wages is insufficient to support the prescribed standard. For an agricultural population the limit is a definite one, imposed by the quantity of land which will repay cultivation, when the cost of labour is up to the required level. The limit can be extended, it is true, either by improvements in the methods of agriculture, or, in an incompletely developed country, by the investment of additional capital. But apart from these possibilities the limit is absolute. The standard of living is a function of the numbers to be employed. As the numbers increase worse and worse land has to be brought into use, and the general rate of wages has to fall to the level appropriate to the land on the margin.

For an industrial population the limit is much more elastic. Once a manufacturing industry is established at a place, if the numbers available for employment increase, and the necessary additional capital can be obtained, an additional output in proportion to the additional numbers

can probably be secured (perhaps more than in proportion). The limit is found not in any local disadvantages, but in the need for markets. If the remuneration of labour is reduced, the price of the product can be reduced and an increased quantity marketed, whereas, in the case of agricultural products the reduction in wages is necessary to effect the requisite increase in output, even at an undiminished price.

It is true that it cannot be taken for granted either that demand can be stimulated to any considerable extent by a reduction in price, or that a reduction of wages will have no adverse reaction on the efficiency of labour. But economic progress, including the accumulation of capital, the improvement of methods of production, and the opening up of new land, usually ensures that an actual reduction of wages (apart from temporary fluctuations) shall not be necessary. As the population of the world increases, that part which is employed on the land is dispersed by emigration over the new countries, while that part which is employed in manufactures is concentrated at the existing centres. These processes are incomplete, and the consequence is overcrowding in certain localities. The places which suffer from overcrowding are those agricultural countries which are either fully developed or cannot secure capital for their further development, and are not in a position to expand their manufacturing industries. Theoretically, as the margin of cultivation spreads and wages fall, manufactures ought to be attracted and stimulated by the prospect of low costs of production. Sometimes that may be so. But a country which is not fitted by its resources and communications to be a manufacturing centre, may get caught in a vicious circle of poverty from which it is unable to escape. Because the people are poor, they are physically weak and insufficiently educated. Wages low enough to mean a miserable standard of living, are not low if paid for a very small output. The opportunity of experimenting to see whether industry can be made to pay will only be afforded if capital is forthcoming. But a poor country cannot find capital from its own resources, and it is not likely to attract much foreign capital so long as the only attraction it can offer is cheap labour.

The most conspicuous overcrowding is to be found in the East, where wages are pitiably low. In Japan, and a few parts of India, a start has been made with industrial development, but industrial capital is extremely scarce. In Japan for example the prevalent rate of interest for good mortgages

or debentures is 10 or 12 per cent., and other investments are in proportion. Access in all directions to the sea is an advantage, and Japan possesses a progressive and resourceful governing class. Since the Japanese have turned their efforts (for good or for evil) towards the development of industry on European lines, their standard of living has been materially raised. Whether they have succeeded in breaking the vicious circle only time can show.

Before leaving the subject of international markets we must turn for a moment to international mercantile profits. Up to this point we have been looking at international trade from the point of view of *producers*. But between the producer in one country and the purchaser in another will intervene a merchant, who will take the responsibility for deciding to what destination the product shall go, and from what source the market shall be supplied. There is no difference of kind between these merchants and those whose business lies wholly within the limits of one State. But there is a considerable difference of degree, for the foreign trade merchant expects to receive profits proportional to the magnitude and complexity of his task. He must have more extensive knowledge than the home trade merchant, for he must be conversant with conditions in the various sources of supply, and in the various markets for the commodity in which he deals. It is not worth while to create and maintain an elaborate organization for keeping in touch with all these places, except for dealing on a large scale. He has to pay heavy transport charges, and to finance consignments of goods for long voyages. For these purposes a large capital is needed. The need for large capital and for special knowledge limits the field from which the foreign trade merchants can be recruited, and enables them accordingly to make high profits.

In Chapter VII we saw that there is a close connexion between mercantile and financial business. The two together are extremely profitable, and to any country in which they are highly developed they constitute a prolific source of local advantages.

To illustrate this, suppose a country which possesses no foreign trade merchants, and the export and import trade of which is in the hands of foreign merchants. The foreign merchants will take their profit from both exports and imports. The prices received for the exports will be so much the smaller, and the prices paid for the imports so much the greater. To preserve a balance, there must be an excess of exports (after allowing for other liabilities in both direct

tions) equivalent to the profits to be credited to the foreign merchants.

Similarly, a country in which there is a large community of foreign trade merchants must receive an excess of imports equivalent to their profits.

We have already seen how a borrowing country experiences a relative increase in the remuneration of labour and in local advantages, in order that it may attract an excess of imports equivalent to the funds borrowed. In the same way a commercially powerful country must attract an excess of imports. The remuneration of labour must rise to the point at which a sufficient proportion of its productive power is being applied to satisfying the needs of its foreign trade merchants in preference to producing goods for export.

As we saw in Chapter VII it is from the profits of trade that the greater part of the funds entering the investment market are derived. But the commercially powerful countries do not necessarily offer favourable openings for fresh capital investment on any considerable scale. These openings are to be found especially in new countries, and the result is that capital is exported on a large scale from the great commercial centres to the new countries. This export of capital must take the form of an increased export or diminished import of goods; to a country which is earning commercial profits abroad the adjustment is easily effected in the form of a diminution in the imports to be received in respect of those profits.

A great commercial centre tends to be not only an exporter of capital, but also a great financial centre. Financial markets require an extreme degree of concentration. If a market of any kind is to function smoothly and efficiently the aggregate daily dealings must be large relatively to the largest single transaction. If a transaction is proposed too large for the resources of the market, the result will be that no concession to the dealers will be great enough to induce them to absorb it. Very large single transactions are characteristic of financial markets, especially of the investment, insurance and foreign exchange markets, and these markets tend to be concentrated in a limited number of very large cities. It is only such cities as are great commercial centres that have sufficient resources to be great financial centres.

Modern improvements in communications have in some respects decentralized financial business. But they have increased the real dependence of the subordinate centres

on the main centres. It is in the main centres (London, New York, Paris, Vienna, Amsterdam) that prices are settled. Dealings on a considerable scale are carried through at innumerable smaller centres, but each of these depends on the great centres for the supply of continuous intelligence as to the course of prices, and for the absorption of any uncovered balance of purchases or sales which it may need to dispose of.

A place gains the position of a great commercial centre mainly through the advantages of its communications. But the merchants who inhabit it must have the necessary aptitudes. Merchants indeed are inclined to migrate to the place where they can do business under the most favourable conditions. Any centre adapted to be a great interpost tends to attract the requisite mercantile talent, unless the State in which it is situated discriminates against foreign settlers.

A commercial centre, once established, tends to hold its position. The difficulties in the way of setting up a rival centre are indeed formidable. The merchants and dealers engaged in the business are collected together in the old centre. Even if other merchants with the necessary skill and capital could be found at the new centre, they do not possess the trade goodwill. The established dealers at the old centre and their customers and clients all over the world have that essential knowledge, not only of the subject matter of their dealings, but of one another's habits, requirements and personal qualities, upon which goodwill is built up. New men cannot have it.

Nor will the established dealers be easily induced to leave the centre they are accustomed to. Quite apart from the natural reluctance of people to move except for very substantial reasons, the mere material equipment of a great city will take a long time to install at the new centre. Not only must office accommodation be provided, but residential accommodation too, together with all the public buildings, shops and appurtenances of a rich community. During the transition, which cannot fail to be a lengthy one, the advantages of concentration will be lost. And this alone is likely to prevent the transition from ever beginning, unless there is such a fundamental change in conditions as to override all the obstacles.

Such a change is to be found for example in a revolution in the means of communication. The decay of Venice after the discovery of the Cape route to India and of the New World is the classical instance. Political changes sometimes

have a similar effect. The displacement of Amsterdam by London in the 18th and 19th centuries was due to political causes. But the decline of Amsterdam was only relative. Indeed the power of commercial and financial centres to survive political cataclysms is wonderful. The revival of Vienna as a financial centre since the Great War bids fair to be a conspicuous example of this.

CHAPTER XII

THE STATE

ALL that has been said since we propounded in Chapter II the Individualist solution of the economic problem has been an elaboration of that solution in its application to actual conditions. The individual has been assumed to sell his labour, to buy and sell commodities, and to make free bargains of all kinds, and we have shown how the whole system is based upon the organization of markets. These operations presuppose much about human nature; they also presuppose much about the institutions, legal and customary, under which the community lives. Hitherto we have said very little either about human nature or about law or custom.

To human nature we shall come in the next chapter. Meanwhile we shall occupy ourselves with what is the greatest of human institutions, and that from which proceed all others, in so far as they are based upon or modifiable by law. That is the State.

The State is itself a part of the solution of the economic problem. For it is an instrument for regulating and directing human effort. Some of its activities are not what is ordinarily called economic. But there is nothing in our definition of the economic problem, as formulated so far, to exclude them. And a very large part of what the State does is of course admittedly economic in the accepted sense.

The essential function of the State is to regulate human action by *authority*. This authority must be exercised by individuals, and, if it is to be effective, or indeed if it is to have any significance at all, the members of the community must recognize it, and must be willing to obey the authorized individuals within the limits of their authority. In a modern civilized society the limits of their authority are defined by law. Law itself is a product of the State, and there is a

legislative organization for the purpose of making and modifying laws. The legislature in turn can be no more than a group of duly authorized individuals, authorized, that is, by law. At the foundation there may be an organic or constitutional law which cannot be altered at all, but this is repugnant to modern political theory, and more usually there is some procedure established for making *any change whatever* in the law, however fundamental, if not through the ordinary legislature, then through some body specially constituted for the purpose.

One primary use of the authority of the State is to enforce certain rules of human conduct, which are for any reason regarded as beneficial to society as a whole. Even where the great majority of people agree in approving of a rule, the State can still fulfil a useful function in enforcing it, because the infringement of the rule, even by a small number, may almost destroy its beneficial effect. And it may well be that, where some are suffered to gain advantages by the breach of the rule with impunity, the majority, who would prefer that the rule should be observed, will nevertheless break it in order to get their share of the gain.

If robbers are not punished, the depredations of a few may make property utterly insecure. And if a few robbers are getting plunder with impunity, many who would have preferred to respect the rights of property will hasten to join in, while there is yet something to steal.

This function of the State has its application to an individualist organization of society. If the motive of the individual's activity is to be found in the enjoyment, either direct or through exchange, of the fruits of his own labour, then these fruits must be assured to him. He must be able to count on security of possession of those material objects which he acquires, and he must be able to enforce agreements relating to the future.

Usually the rules of conduct enforced by law must be such that in the great majority of cases they are obeyed without any active enforcement at all. The State then does no more than supplement custom and opinion.

The State's authority itself rests in part on custom and opinion. But it cannot count on this support from all people in all circumstances, and when we speak of the State enforcing a law we mean that in the last resort it will use *force* against a recalcitrant; it will exercise compulsion upon him by an effective threat of physical injury or death. Against the organized force of the State isolated individuals are helpless. If they have offended against the law, and concealment has

failed, they have no choice but to pay such penalty as the State may ordain.

The possession of organized force is a characteristic attribute of the State. Organized force means simply the principle of the division of labour applied to attack and defence. To each man his task in the general scheme is allotted by authority.

Organized force can exist without the authority of the State. A band of robbers, the paid retainers of a great lord, the enthusiastic associates of a rebel, may voluntarily establish the necessary mutual relations of discipline. But so superior is the authority of the State as a basis of organized force, that, save in rare cases where the State itself is subject to some tremendous cleavage, nothing can stand against the force of a State except that of another State.

The chief reason for this is that organized force requires not only discipline among the individuals by whom it is exercised, but also great material resources for their equipment and maintenance. Experience. shows that adequate material resources can rarely be secured by voluntary effort. The State obtains what it needs through its *taxing power.* It uses its authority to impose upon the community by law compulsory contributions of money.

This use of the authority of the State is especially significant. In the first place it is, so far as it goes, a direct infringement of the principle of individualism, in that it takes from the individual a part of those possessions which constitute the motive of his economic action. The individual receives something less than the exchange value of the fruits of his own labour. Where taxes are light, the infringement is a trifle. But where they are heavy, it is no longer negligible, and there is no definite stopping place (apart from a possible breakdown of the fiscal machine) between taxation and a general confiscation of wealth.

Secondly, taxation, though itself an infringement of the individualist principle, is yet a concession to that principle. The State can use its authority directly to compel people to render services to it. It can, for example, compel able-bodied men to enter military service, or it can institute compulsory service on juries or compulsory road-mending As an alternative to compulsory services, the State can exact money by taxation, and obtain the services it requires by offering suitable remuneration through the labour market.

The compulsory contribution of money, though contrary to individualism, is susceptible of a more judicious adjustment to circumstances then compulsory services. A money

contribution can be distributed according to some impartial principle over the whole community, and the sums raised can be applied to the payment of a limited number of specialized employees. Compulsory service can only be spread over the whole population at the cost of sacrificing the advantages of the division of labour.

Thirdly, a compulsory contribution of money is a slighter encroachment on individual freedom than compulsory service. The former only deprives the individual of a part of his money; the latter both deprives him of money (or more directly of part of his power of earning money) and also dictates to him the manner of using a part of his time.

It is probably true that in the history of mankind taxation has been resorted to in the first instance, to provide the means of attack and defence. But, once started, taxation can be used for other purposes. And the remainder of this chapter will be devoted to the economic activities of the State other than those, such as warfare and the enforcement of law and order, which depend upon the use of force.

These economic activities exhibit the State as in some degree an *alternative solution* of the economic problem. The motives of the individual seeking pecuniary gain are not of themselves sufficient to do what is required, and the authority of the State is called in aid. Such cases constitute in themselves an implied criticism of individualism, though we shall not indulge in any explicit criticism of one solution or another till we are ready to embark upon our philosophic enquiries.

The first group of cases is one where the taxing power of the State does not necessarily or usually play a part; that is the group of what may be called public utilities.

There are certain services necessary to a human community (especially under modern conditions) that are so essentially *localized* that there cannot be a free market in them Inland communications, whether by road, rail or waterway, are an obvious example. The route followed by a railway for instance depends on natural features. The first railway to be constructed between two places will probably occupy the most favourable route. It will be undertaken when the probable traffic promises a sufficient profit to meet the interest charges upon the necessary capital outlay with a reasonable margin over. But there must be much further development, probably occupying a long period of time, before (if ever) the traffic becomes sufficient to cover the interest charges upon a *second* railway. And even then

the construction of a second railway would be a superfluous and wasteful proceeding until the traffic had so grown that the existing line could not cope with it. It is only in exceptional cases that that happens at all. And as a rule competition in rail transport between two places only exists when two or more lines are constructed to serve different groups of intermediate places.

The market in rail transport between two places is likely therefore to be one containing only a single seller ; at most it will contain two or three. We have already shown how vital are the means of communication to a human community dependent on the division of labour. If the means of communication are supplied by a monopolist, who can charge what price he pleases, and vary his charges as he pleases, the communities which he serves will be completely in his power. Even where two or three alternative routes exist, the profits to be obtained from a monopoly would be so tempting that the proprietors of the competing lines would sooner or later combine.

The injurious effects of unrestricted private ownership and exploitation of railways are by no means confined to the excessive payments that may be exacted for the transport facilities afforded. Indeed, in view of the importance to a railway enterprise of obtaining adequate traffic, the charges would not necessarily and in all cases be very high. In the long run more harm is done by the uncertainty as to the future. If a district is to be developed by the construction of railway communication, that means that people must settle there, and capital expenditure must be incurred, both on the material means of production, and on the provision of housing accommodation and other necessities of civilized life. The calculations of those who incur this capital expenditure are based on the continuance of the railway transport, the existence of which originally attracted them. That the railway will continue to exist and to work they may assume without much risk of disappointment. But at what price ? A reasonable level of railway charges is an essential factor in their calculations. If development proceeds on the assumption that charges will remain reasonable, and if, when it has made substantial progress, the charges are raised, those who have embarked their capital in the development cannot go back. They are caught in a trap, for they must bear the increased charges even if the effect is to reduce the yield of their capital almost to vanishing point.

Such a state of affairs is not in the interest of the railway itself. By setting the trap successfully it might make large

profits, but the mere risk of future extortion will prevent capitalists from developing the district, and will prevent the railway from getting even a reasonable and legitimate profit. It is difficult for a railway company to enter into a binding agreement for all time, or to enter into any sort of agreement with an unorganized body of settlers. It is to the interest of all parties that the continuance of reasonable railway charges should be secured not by agreement but by the authority of the State. Maximum charges can be laid down by law, and development can proceed on the assumption that they will not be exceeded

Railway development calls for the interference of the State in another direction. The route of a projected railway probably crosses the property of many different landowners, from each of whom enough land for the track must be bought. To buy this land by a series of voluntary bargains is obviously very difficult. Each bargain is dependent upon the others. If one landowner refuses, the route must be altered and new bargains with the neighbouring owners become necessary. Each landowner can ask an exorbitant price, representing not the value of the land to himself, but the cost that would be thrown on the railway projectors by a failure of the negotiations. As a rule the only way out of the tangle is to invoke the authority of the State to enforce compulsory sales of the necessary land. The railway projectors satisfy the legislature that the construction of the railway is in the public interest, and that the route chosen is a reasonable one from the point of view not only of the working of the railway but also of the convenience of the landowners affected. The legislature then enacts that the landowners must sell so much of their land as is required, at prices not appreciably exceeding the value of the land for other purposes.

Seeing that the provision of railway transport cannot be left to unfettered private enterprise, it is not unnatural that the State should, in some cases, solve the problem of control by itself undertaking to build and work the railways, supplying the necessary capital from its own resources. There are indeed weighty reasons for this, apart from the dual responsibility inseparable from private enterprise in such matters. Private capitalists will not promote a new railway till the need for it has already reached such a point that the receipts to be expected from it will be sufficient to yield interest on the capital outlay, together with an adequate profit. But the pecuniary return is but a small part of the benefit that the community may be expected to derive from improved communications. New local advantages will come into

being in the districts to be developed, and the people who move thither can be employed to better advantage. The State can choose the time for starting a new railway enterprise, and can give the preference to those openings for railway development which promise the best results on the whole, without necessarily promising the highest profit. Many other arguments for and against State ownership of railways can of course be adduced, but it is not necessary to pursue them here.[1]

One point however, emerges. It is not essential that a State-owned railway should earn a profit, or even that it should earn interest on its capital cost. To the private capitalist a fair rate of interest at least, with or without a margin of profit, is the only motive for coming forward. The State can take a broader view. And once the railway is constructed, it is desirable that it should be as fully *used* as possible. The higher the charges, the less will be the traffic. If the charges are to cover interest on first cost, they must be higher than if they cover no more than the actual cost of working. It may be that the State raised the capital sum required by borrowing and is itself paying interest on the loan. If the railway charges do not cover the interest the necessary funds must be raised by taxation. But to fix the charges high enough to cover interest is really to raise the money by a tax on the use of the railway. This may be the wisest way to raise it, especially if it does not to any appreciable extent diminish the use of the railway or retard the development of the district served. But an advantage of State ownership is that it allows the choice whether the interest charges shall be raised in this way or another.

Canals and harbours raise very much the same problems as railways. Ordinary roads, however, differ in some respects. In the first place the land problem is with them less prominent; partly because the provision of some means of access is so elementary a need that the land along the most suitable routes is almost invariably devoted to the means of passage before the private ownership of land in the district has grown up at all; partly because private landowners will often of their own accord, lay out the necessary roads on their own property.

Nevertheless the spontaneous action of individuals is not in practice adequate, and the authority of the State has to be invoked, both to secure the establishment of the requisite rights of way, and also to construct and maintain

[1] A great part of the controversy is concerned with the relative efficiency of the State and a private company in management and working.

roads fit to carry the traffic using them. The capital cost of roads is not so serious as that of railways, and it can be spread over a long period. The simplest kind of road costs little, and the surface can be gradually strengthened and improved as the growth of traffic demands. The process may be spread over centuries in a country where growth is slow.

For these reasons the problem of how to meet the capital cost of roads is never very acutely felt. On the other hand the cost of maintenance has often been a source of difficulties. On a railway the business of transportation involves heavy current costs, and, whatever policy may be followed in regard to the interest on capital outlay, a charge is in any case made for the use of the railway so far as may be needed to meet these costs. That is not because the gratuitous use of railway transport is necessarily undesirable or wasteful, but because the organization of a railway, where the rolling stock belongs to the same authority as the track, lends itself readily to the exaction of payment.

This is not so with roads. On roads people use their own vehicles. Any interference with their freedom to come and go is vexatious. In England in the 18th century, when great difficulty had been experienced in finding a suitable public authority or adequate funds for keeping up the roads, a solution was found in the institution of turnpikes, where tolls were levied on all vehicles that passed. The result was a notable improvement in the roads, but the inconvenience of the system was so patent that in the course of the 19th century it gave way to the provision of revenue for the highway authorities as part of the local taxation system of the country. Recently the introduction of mechanical road transport has added heavily to the cost of the roads, and a new source of revenue has been found in the taxation of the motor vehicles themselves. This is part of the central not of the local taxation system of the country. The gratuitous use of roads, throwing the cost of upkeep on the tax-revenues, (local or national), is now usual throughout the world.

Inland transport is only one example (though an important one) of the class of public utilities. Another is to be found in the conveyance of messages. The conveyance of letters presupposes the existence of a transport system, but nevertheless constitutes a separate problem. If it ranks as a public utility, that is for two reasons : first that the existence of adequate and reliable postal facilities throughout the community is a matter of great public importance, by no means sufficiently measured by the pecuniary profit derivable

from it ; secondly that it is a business in which duplication of local organization (though more often practicable than in the case of inland transport) is too wasteful to last, and tends always to give place to a monopoly. To ensure economical working and uniform facilities the postal service is commonly made a Government monopoly. Similar considerations apply to communication by telegraph or telephone. It is the ordinary practice of Governments to charge fees for the use of their services as carriers or transmitters of messages, sometimes at rates just sufficient to cover costs, sometimes at rates sufficient to yield a profit.

Other instances of public utilities are the provision of water, drainage, gas or electricity for towns, and various minor serivces which we need not explore in detail.

The distinctive feature of a public utility is that it is a service in the provision of which the *market*, the characteristic organ of individualist society, does not work smoothly or effectively. There is another class of State activity, which has acquired increasing importance in recent years, and which is a more direct challenge to individualism. This is in the provision, at the expense of the State, of certain services which are believed to be particularly desirable on social grounds, and which are not likely to be supplied efficiently and on an adequate scale in response to the consumers' spontaneous demand. The market works efficiently, but its results are condemned and rejected. The value that it indicates for the service in question is not high enough to satisfy the requirements of public policy. The State steps in, to offer a higher price to the producer, and to dispose of the product either free or at a lower price to the consumer.

The most conspicuous of the services so dealt in by the State is education. Insurance of the working classes against ill-health, loss of employment and old age also supplies a noteworthy instance, and along with these forms of insurance there are to be found ancillary services such as the provision of medical attendance and the organization of employment exchanges.

Closely related to such services is the policy of the poor law. Individualism aims at assigning to everyone a share in the products of the community equivalent to the fruits of his own labour. But subsistence itself is dependent upon that share, and the question arises what is to be done when for any reason someone's share is inadequate for subsistence. That may happen through either his misfortune, or his fault, but, even if it is through his fault, starvation is a heavy

penalty for idleness or improvidence. In any case it is difficult to draw the line between fault and misfortune. The rigours of individualism must be supplemented by some public provision for those who fail to provide for their own subsistence, whatever the cause.

CHAPTER XIII

THE MOTIVES OF THE MARKET

THE economic problem is a problem in human nature. The classical economists were defenders of the individualist solution, and they have been subjected to scathing criticism because in their defence they took too narrow a view of human nature. They concentrated on the motives of the market, and were accused of shutting their eyes to everything else.

The accusation was not, at any rate was not always, justified. For certain purposes it is legitimate and useful to make use of a highly abstract version of human nature. in order to simplify an economic investigation, provided that the results are not thereafter assumed to be true without qualification of human nature as it is.

For our present purpose, however, an abstract version of human nature will not do. In the preceding chapters indeed we have repeatedly traced the working of the motives of the market, in disregard of other aspects of human nature But now we are about to take a wider outlook, and to criticize the individualistic and other solutions from the standpoints both of the ends sought and the means employed. In doing so we cannot avoid making incursions into the realm of psychology.

In our opening chapter we had something to say of man's dual nature, the animal and the rational. His instincts come from his animal nature. One of the puzzles in a study of human motives is to draw the line between instincts and other propensities. The prudent psychologist will beware of postulating the existence of independent instincts on insufficient grounds ; he will bear in mind Occam's " razor": *entia non sunt multiplicanda præter necessitatem.* Even the instincts which indisputably exist are intimately blended with our rational nature, and the two must be disentangled to be understood.

We are always liable to under-estimate the complexity of the processes which go on in our own minds. We do not allow for the narrow limitations within which introspection works. It is ordinarily possible to recall voluntarily only those experiences or states of mind to which we have *attended* when they occurred. Those which were outside the focus of attention are as if they had never been. One who derives his psychological evidence exclusively from introspection is likely therefore to neglect whatever is not attended to. And, when confronted with clear proof from human behaviour and experience that some activity has occurred which has all the characteristics of consciousness, but yet is not within the field of introspection, he calls this activity subconscious. The word explains nothing. It cannot make possible a state which both is and is not conscious.

In reality all that requires explanation is that experiences which *are* conscious are not *recollected*. That is a matter that concerns the psychologists. What matters to us is that the so-called subconscious experiences are *conscious;* in them we find the human mind judging and reasoning, forming impressions and reaching conclusions, and we must not hastily write off as instinctive behaviour which may arise out of these processes.

It may further be pointed out that, even where thought is evolving in the very focus of attention, it frequently eludes efforts to formulate it owing to the shortcomings of language. For the purpose of recording the results of thought for future use, we are very dependent upon language, but thought is much more subtle and complex even than the most perfect languages.

We are prone to leave out of account so much of our thought as we fail to express. If we do, we undervalue the powers of the human mind. Childish, primitive, or uneducated minds entertain thoughts which they themselves are quite unable to express. Nor would they even recognize their thoughts in the expression which more sophisticated people would find for them. Perhaps the most important contribution that psychology has to make to the economic problem is in insisting upon recognition for this great wealth of sub-conscious or unexpressed intellectual activity.

Let us turn first to the motives of the market. He who comes to market, whether to sell his own services or some material product, or some right or property, comes to get money. He comes to get as much money as the market will yield him.

Now money is no more than a medium of exchange, and it seems natural and inevitable to take it for granted that he seeks money, not for its own sake, but for the sake of what it will buy.

That is one of the economist's axioms, and perhaps it is true more often than not. To the man of slight resources, whose very subsistence depends upon his selling his labour, the money he earns is often translated in his mind into terms of commodities before he receives it. And in all social strata that is true sometimes and of some people.

But it is certainly not true at all times and of all people. There is in human nature a very prevalent, very strong and very real desire for money *for its own sake.* "Money" here must be taken in a wide sense, to include any possessions such as investments, which are held for the sake of the income that they yield or of the capital sums for which they can be sold or pledged.[1]

In practical life we are never surprised to find this desire for money, either in our neighbours or in ourselves. But such is the deference that we feel for the reasoning of economists, that we dare not admit that something which they have proved to be impossible exists. To many people the suggestion that men (other than eccentric misers) love money for its own sake will appear to be a daring paradox.

It may be readily admitted that so perverse a desire requires some explanation. A workman dependent upon his own earnings will endeavour to save something, in order to escape from the precariousness of a hand-to-mouth existence. He will accumulate a reserve of money or purchasing power, to enable him to live during any temporary interruption of his earnings. Such a reserve is valued for the security it gives. In a sense it is valued for the things it will buy, for it only gives security because it will buy them.

Now security against starvation could be obtained by spending the reserve of money upon a reserve of food. But a reserve of food (even if we leave out of account the difficulty of storing and preserving it) will not do everything that a reserve of money will do. The money carries with it *freedom of choice* as to the things to be bought, It is available against other contingencies besides a scarcity of food.

Money, in virtue of this freedom of choice, gives a strategical advantage—a central position, from which the

[1] A man who possesses the physical capital or actual equipment of a business possesses wealth as distinguished from money. Nevertheless he regards it as a source of money income, just as much as a bond which gives him nothing but the right to receive an annual sum of money.

defence can be directed at will to any part of the household economy that may be threatened.

As we pass from the tiny hoard of the poor man to the extensive investments and properties of the rich, this attribute of money becomes not less but more attractive. Money is valued, not only as a security against the various economic risks to which human life is subject, but as a source of power over the productive resources of society. So long as the money is *not spent*, there is no limit to the variety of prospective benefits that the spending may bring. Let it be spent, and all possibilities but one are once and for all ruled out.

To put the same thing in another way, the receipt of money marks a stage on the journey which starts with the effort of earning (or otherwise becoming entitled to it) and ends with the enjoyment of the things earned. Up to that stage there is no room for doubt or hesitation ; whatever the end is to be, the acquisition of money cannot fail to be the means. But to complete the journey is to make the irrevocable choice among all possible objects of expenditure. Were the choice easy, there would be no reason to stop short at the first stage. But in reality the spending of money is a difficult art, and one which troubles society much more than either economists or other mortals usually allow.

Social convention in all stages of civilization has worked out methods by which any income, however great, can be spent, and many rich people are content to follow it uncritically. But to those whom its solution does not satisfy, the problem is a very real one. Their natural refuge is to confine expenditure to what they *certainly* wish to have, and to accumulate the rest of their resources unspent.

The desire for money for its own sake plays its part, along with other motives, as an incentive to accumulation. In the case of very big fortunes it may even be the predominant motive, when considerations of mere prudence or the desire for independence have been more than met.

But the influence of the desire for money upon human affairs extends far beyond its direct effects upon accumulation. Practical decisions are usually the result not of exact calculation but of *judgment*. All relevant circumstances have to be taken into account, and must be discounted in proportion to their uncertainty.

Any factor in these practical judgments which is precise and certain gains proportionately greater weight. Among all possible objects of action money stands out as one of the desirability of which the mind feels least doubt, and for that reason it tends to assume a preponderance in practical

decisions, outweighing advantages which, however great, are yet matters of opinion.

Though the desire of money for its own sake plays so prominent a part in the motives of the market, that does not mean that the desire for it for the sake of the things it will buy is unimportant or secondary. The desire for products is itself highly complex. One of the anomalies of individualism is that in theory it makes the very subsistence of the individual depend in the majority of cases upon his power of selling his labour in the market. The poor law, it is true, intervenes to avert the danger of actual starvation. Nevertheless in the markets of an individualist community the demand for the barest necessities of life competes on equal terms with the demand for the most frivolous superfluities. We shall have to give further consideration to the objects of expenditure when we come to treat of the ends of economic action, and we shall not pursue the subject at this stage.

The love of money may be regarded as a particular case of the love of power. It is equally true of power that, while people value it for what they can get by exercising it, they also value it for its own sake. Power in itself may always be presumed to be desirable; its exercise *can* bring advantages, and, if not, the fault may be supposed to lie with its possessor. At the worst the possession of power without its exercise can do no harm. In so far as power carries responsibility, this reasoning is fallacious, but under the reign of individualism money carries no responsibility.

This love of power is sometimes regarded, if not as an instinct, at any rate as something ultimate in human nature. It may be so. But on this our preliminary remarks upon sub-conscious reasoning have a bearing. What has been said in explanation of the love of power and of its particular application, the love of money, goes to show that fundamentally it is not instinctive, but *rational;* not ultimate, but the outcome of circumstances. If that is so, then, as circumstances change, the love of money may change.

Analogous to the desire of power is another motive which plays a large part in human society, the desire of *independence*. This has various ramifications in the individualist organization. Theoretically the market is based on independence. It is open to all sellers and all buyers; they come and traffic on equal terms. Everyone engages in whatever form of production he chooses, and the reward is determined by the free play of the market. If buyers and sellers alike were an infinite number of separate atoms, their indepen-

dence would be complete. In many if not in most markets, however, sellers are dependent in some degree on the goodwill of buyers. The smaller the number of buyers with which a seller deals, the less can he afford to lose one of them. Where buyers are few therefore (and still more where they are united in a ring so that effectively there is only one buyer) it is possible for them to put pressure upon the sellers, and not merely to extort a high profit, but to compel them to do things that may be only indirectly or remotely connected with the business in hand. Likewise (though rather less commonly) sellers of essential supplies can sometimes put pressure upon buyers.

This kind of dependence is most serious in the labour market. The wage-earner under a contract of service has, so long as the contract lasts, only one buyer of his labour. If he is dissatisfied, he can terminate the contract, and seek employment from someone else. But the number of employers in his trade who are within easy reach of his home is limited, and is in general likely to be small. Among these his choice is restricted to those who happen to have a vacancy. To go far afield in search of employment may be a matter of great difficulty. Thus the disadvantages of terminating his contract of service may be prohibitive, and he may be compelled to accept whatever conditions his employer chooses to inflict upon him.

The service of an employer in any case involves incidents which may easily become irksome. The organization of a productive business with a number of employees requires discipline. The contract of service must include subjection to this discipline. The master and his representatives exercise authority, and this is a limitation upon the freedom of the workmen. It exists, it is true, only within working hours, but the hours themselves are a matter of discipline; they may be unduly long, or, if they are not normally so, they may be extended on occasions when more work is required.

Many kinds of work expose the workmen to offensive, unhealthy, fatiguing or dangerous conditions, which may be materially aggravated or mitigated by the action of the employer.

The dependence of the workmen upon their employer is sometimes increased by his providing them with housing accommodation. If loss of employment means at the same time eviction from home, the workman is even more unwilling to face it.

The organization of labour in trade unions has grown up at least as much to end this state of dependence upon

employers as to secure a reasonable market wage. To the individual it involves a new kind of dependence. But dependence upon a democratically organized association of equals with a common interest is tolerable. It is accepted as the necessary means to independence in a direction where independence is far more highly valued. The labour movement cannot be fully understood apart from this desire for independence. In it is to be found the explanation of the readiness of organized workmen to put their strength to the test in a strike often apparently for very trifling ends. More particularly does it explain the tendency, which has become so prevalent in recent years, to make a strike in any industry as complete as possible, and to extend it, if possible, to other industries, or even to *all* industries. When a strike is organized in an industry, in order to secure some concession (either in the rate of wages or in the conditions of employment) from employers, the natural course is for the workmen to go on working for those of the employers who grant the concession. The pressure on those who refuse it is thereby increased, because their competitors, who have granted it, get all the business, and at the same time the workmen who go on working for these latter can contribute funds for their fellows who remain on strike. In the strikes of the 19th century this policy was ordinarily pursued.

Nowadays, on the other hand, a strike in an industry often means the entire suspension of work, without regard to the willingness of individual employers to grant the concessions sought.[1] The underlying policy is to look beyond the employers to the general community, who may be expected to suffer from the complete suspension of the supply of the product in question.

From a practical point of view the only advantage of this policy is that it may compel the intervention of the Government, either to mediate in the dispute, or possibly to obtain legislation in the interests of the workmen. But what recommends it to the workmen is not so much the practical consequences (the advantages of which are dubious) as the opportunity afforded of vindicating the independence of their class.

This illustrates the close relation between independence and power. The strikers seek to prove their own independence by proving the dependence of the community upon themselves.

The desire of independence also makes itself felt in a

[1] It is also true that employers are often so well organized that none grant the concessions which their association refuses.

reluctance to accept material benefits conferred not as a matter of right but as a matter of favour. The reluctance does not exist in all people, nor in anyone in all circumstances. But it is prevalent enough for purely voluntary benevolence not to be a solution of human distresses except in special circumstances and for short periods. To accept benefits without these limitations is to put oneself in the power of the benefactor, who can, if he pleases, withdraw them. This applies sometimes even where the benefits take the form not of pure charity but of payments for services rendered or goods supplied, so long as the bargain arises solely from the personal initiative of the benefactor, without contact with the market.

Without venturing such a thing as a complete analysis of the motives of the market, we ought nevertheless to mention one more—ambition. Ambition is not a purely economic motive, still less purely a motive of the market. It finds its field more especially in service under the State or in intellectual or artistic work. Nevertheless one branch of it is concerned with success in the market. Ambition aims not merely at achievement but at achievement publicly recognized. The recognition may be given by popular fame, or by celebrity within a restricted but discriminating circle, or by honours officially conferred, or by pecuniary reward. Money, as we have seen, is valued for its own sake. Whatever other possessions may be worth having, money at any rate is desirable, for it is the road that leads to all alike. Just because the acquisition of money is thought so indisputably advantageous, the possession of it becomes in the eyes of men a symbol of success and a ground of honour. Thereby the desire for money is itself reinforced. Rich men often indulge in the ostentatious expenditure prescribed by convention, not because they care about the objects upon which they are spending their money, but in order that they may give external evidence of their superfluity, and gain the honour due to it.

And the taint of the money test infects all careers. The greatest intellectual and artistic achievements can only be fully appreciated by the few, and they often bring little or no pecuniary reward. Yet those who give their lives to them (unless they have other resources) must be content with the money they receive. To the multitude they appear to be on the same footing as anybody who lives by the sale of his services in the market, and their success is measured by the price they receive.

A great man can rise superior to this mean appraisement

But only a high degree either of enlightenment or of self-confidence can make that possible. A man who is not fortified by one of those two attributes will judge the value of his own work partly by the value that his neighbours appear to put on it. That value, he may well think, is better tested by the money they will pay for it, than by the praise they will accord to it. For fair words cost nothing.

The field of ambition is not restricted to the higher walks of life. Every vocation has its possibilities of greater or less achievement. In very many there is no test of achievement except success in contributing to the production of a marketable commodity, and of that the measure is almost bound to be the price paid for the services rendered. In practice other tests, such as the reluctance of an employer to part with a man's services, or the delegation to him of authority over other employees, are usually all summed up in the amount of remuneration given.

Ambition also discriminates between one vocation and another. Those which need most intelligence, or initiative, or taste, or knowledge gain consequence on those grounds. Something of the recognition appropriate to success in the vocation is accorded to the vocation itself. But in general a man is not deemed to be really embarked in the vocation unless he is deriving an adequate income from it. Here also therefore the pecuniary test intrudes.

CHAPTER XIV

THE FAMILY

IN the preceding chapter we have been analysing the self-seeking motives which work in the market. We shall next turn to a group of motives which are, in the main, not self-seeking. However obscure and doubtful the limits of instinct may be in some directions, it is at any rate indisputable that not only the procreation but to a great extent also the nurture of children is provided for and governed by instincts. These instincts, the most powerful perhaps to which we are subject, are to be found in one form or another throughout the animal kingdom.

To the economic problem they have a very special relation, in that they are directed to certain kinds of co-operation, and are therefore themselves part of the solution of the problem, a part which is not planned, but is given in our nature. But instinctive co-operation in itself goes no further than to bring male and female together, and to secure maternal care for the progeny.

It may perhaps be contended that paternal care is also instinctive. There are many obvious parallels among animals, where the young are brought up and fed by the joint efforts of the male and female. But this is not universal, and what we know of primitive man does not suggest that it is true of the human race. Not only does the matriarchal system (which appears to be more primitive than the patriarchal) imply at any rate a looseness in the tie of paternity, but there are races which are reputed to be ignorant of the very physical fact of paternity itself. Such evidences are not conclusive. A paternal instinct may exist, and may yet have been thrust into abeyance by social institutions. If that is so, that means that the family itself, as we know it, is a reversion to a natural group, based on instinct, temporarily abandoned at one stage of development by primitive man.

It is perhaps most likely that paternal responsibilities, so far as they are not the result of law, morality and social

convention, rest partly on a paternal instinct, which is the result of an incomplete differentiation of the sexes, and partly upon the attraction of the male to the female. A more or less permanent cohabitation would naturally throw upon the man the responsibility of supporting the woman, not only while she is actually incapacitated during childbirth, but while she is pre-occupied with the care of the children.

Whatever the instinctive basis of the family may be, it is obvious that some provision must be made in every human community for the support of the women while they are engaged in bearing and rearing their children This does not *necessarily* mean that the women must be supported by the men. In some parts of the world, where nature is bountiful and wants are simple, the men are maintained in idleness by the women, who somehow find time and energy to work in the fields despite the distractions, physical and moral, of bringing up children.

But in civilized society this is impossible, and the primary duty of earning the means of support is placed upon the man. From this fundamental need proceeds the organization of the family.

The principle of the family is that the man who once mates with a woman must undertake to remain permanently with her and support her and her children. She on her side must remain faithful to him, so that he is not saddled with the responsibility for any children other than his own, and must give all the necessary care to the children till they are old enough to take care of themselves.

These very definite and very onerous obligations are not accepted through instinct. They are, it may be said, imposed by custom, reinforced by law. This is in a way true. But the conception of custom does not convey the full power of the obligation.

In our opening chapter it was suggested (though on such a point it would be wrong to dogmatize) that the labour of primitive man was given in response not to remuneration, like that of a modern workman, nor to force, like that of a slave, but to a non-rational sense of obligation, like that of a bee. The economic functions of the family rest on just such a non-rational sense of obligation.

The sense of obligation is something much deeper and stronger than mere conformity to custom. To call it *sacred* is to attach to it all the implications of a word which has been progressively spiritualized and rationalized by the same process of evolution as religion itself. A more appropriate term is one which has been borrowed from primitive

religion, the Polynesian word *taboo*. In it we have the concept, *sacred*, divested of its later and higher implications.

It is not necessary to offer any very exact definition of a taboo. It may be described as a rule enjoining (or prohibiting) certain kinds of behaviour towards an object, which may be a person, a material thing, a piece of ritual, a place or a time. Frequently (but not necessarily) this object is regarded as sacred, and the behaviour prescribed is such as to indicate reverence for it. The rules of taboo are not regarded as directed to any ulterior purpose ; conformity with them is not a means, but an end ; infringement is something shocking, not on account of any evil consequences that may be expected to follow, but essentially and in itself. Evil consequences may, no doubt, be expected ; but that is an afterthought. Primitive man, convinced of the paramount duty of conforming to his taboos, cannot think that one who breaks them will go unscathed. He believes that something terrible will happen to such a delinquent, as fifty thousand of the men of Bethshemesh were struck dead for looking into the ark. But the evil consequences attributed to the breach of the taboo are of the nature of a *penalty*. The avoidance of the consequences is not the *purpose* of the rules.

The supposition of a penalty is part of that process of rationalization to which religion is always being subjected. The same rationalization also finds reasons and purposes for taboos. They are stated to be the commands of God, or the acts enjoined are explained as having good consequences and those forbidden as having bad consequences not by way of rewards and punishments, but as quasi-scientific or magical laws. Such explanations are inconsistent with the pristine simplicity of the taboo ; they really change its essential character. But rationalization must make a great deal of headway before the basis of the rules is really altered. For long the taboo rests on the old secure foundation of unreason, and the explanations of magic, or mythology or of theology are tentatively accepted by only a few enquiring minds.

This is true even of the Christians of to-day. Many people would be horrified at the idea of making a casual meal off consecrated bread and wine (as David ate the Shew bread) even though they might have very incomplete knowledge of the teaching of any Church, Catholic, Protestant or Orthodox, as to the significance of the sacrament. Perhaps the more rationalized their belief the less horrified would

they be. A simple example of a taboo in modern Christian society is the rule requiring a man to take off his hat on entering a church. The rule is commonly observed without any consideration of its significance, and the breach of it is regarded as much more shocking than any mere breach of custom (such as omitting to wear a tie).

Another example is our attitude towards the use of expletives. It is the purpose of an expletive to be shocking, and the extent to which any particular word achieves this purpose is determined not wholly by its meaning, but partly also by a conventional but deep-seated sentiment.[1]

Though the rules of taboo are accepted as ends in themselves, without regard to any ulterior purpose, that does not mean that they cannot in fact serve a purpose. What is essential is that this purpose, if any there be, should not be the ordinarily accepted ground for obeying the rules. As soon as the progress of rationalization reaches such a stage that the purpose becomes the whole ground of obedience, the rules finally lose the character of taboo.

And yet this purpose may in a sense have been the real reason for the original establishment of the taboo. We showed in our opening chapter how the sacred observances of primitive man may in many cases have served important practical ends. We need not take it for granted that such observances invariably grew up without any conscious initiative on the part of individuals. The intellect of primitive man undoubtedly laboured under some grave disadvantages, more especially in the imperfection of language. But, where language is imperfect, the mind itself is not necessarily any the less acute; it is only less capable of recording or communicating thought, and loses thereby the advantages of sustained trains of reasoning, and of adequate consultation between one man and another. In any case thought, even in the most sophisticated minds, often outstrips language. Some among the wise men and elders of primitive times may have been quite clever enough to understand the practical consequences of some of their observances, and may have deliberately initiated or adapted taboos for the sake of their consequences.

Origins can only be the subject of conjecture. But in civilized society, as we know it, we find the rules of taboo not dependent upon their practical consequences, but closely associated with them. The rules still exist, but are

[1] Even when the force of an expletive is the direct result of its meaning, that is usually because the meaning itself contravenes some religious or social taboo.

defended and reinforced by reason in those cases where they have advantageous social consequences.

That is true of the taboos upon which the family rests. These taboos relate partly to sexual intercourse, partly to the rights and obligations of marriage and kinship. Those of the former class are directed to such purposes as forbidding any opportunity of sexual satisfaction other than through marriage, preventing, as indecent, any behaviour in public which might inopportunely arouse sexual instincts, and enjoining the mutual faithfulness of husband and wife. Conflicting as they do at many points with the powerful instincts of sex, these taboos, even with support from religion, from morality and from the authority of the State, can never be more than very partially observed. Nevertheless family life is so generally established as to be the normal unit out of which society is built up.

Of the obligations of kinship, that of the man to support his wife and children, that of the woman to care for her children and that of the children to obey their parents are fundamental. Derived from these are the obligations of children, after they have grown up, to support their parents in old age, and also a general and rather ill-defined obligation of relations to help one another. Friendship, without ties of blood, frequently leads people to give one another material or pecuniary help. But, apart from purely philanthropic charity, that is only possible when a certain degree of intimacy or sympathy has been reached, and between friends there is often a reluctance to accept money, which almost amounts to a taboo, and which may perhaps be traced to a fear that the friendship may be endangered by the intrusion of pecuniary obligations. Between relations on the other hand there is no such bar. The obligations and rights of parents towards their children are transmitted to the children themselves, and reappear as mutual rights and obligations among brothers and sisters. There is a partial identification of interests, which passes down from generation to generation so that it extends even to the more proximate collaterals.

The economic organization of society is profoundly affected by the existence of the family. Incidentally the prevalence of the type of household composed of man and wife and children (with the addition only in a limited number of well-to-do families of domestic servants) leads to the performance by married women of a number of services, such as cooking, shopping, mending and cleaning, without any remuneration. Because these services do not

come into the market, their value is apt to be underestimated, especially by the earlier economists. Working-class wives are often harder-worked than their husbands, and the household services they render are of the greatest consequence from the standpoint of social well-being.

But this is only a bypath. The family exists for the sake of the children. The parents' obligations towards the children include the provision of maintenance, protection and education. Upon the continued discharge of these obligations depends the future of the community. As regards maintenance and protection, children are wholly incapable for the earlier years of their existence of either supporting themselves, or taking precautions against the most ordinary risks of life. They are absolutely dependent upon other people. The standard of maintenance their parents can give them is limited by the parents' own resources. If those resources are slender, there is a tragic struggle between the immediate needs of parents and children. If this often means that the parents face bitter privations for the sake of their children, that is not solely due to instinct, and to the rules of taboo, but partly also to a wider sense of obligation and to the promptings of sympathy and affection. But the sympathy and affection originate in instinct, even though they may grow far beyond the animal and into the spiritual nature. And the sense of obligation, however enlightened and rationalized, is reinforced by the taboo, working not only in the individuals concerned, but throughout the community in which they live.

Thus, if devotion of parents to children is not a freakish exception, but is so common as to be the rule, a substantial part of the credit is due to the taboo, to the unreasoning but intense belief in the obligations of the family. The economic system of individualism had to take the family for granted, and in the palmy days of the classical economists any suggestion that the sense of duty of parents was insufficient to safeguard the interests of children aroused indignant controversy. Proposals for supplementing the efforts of the parents by State interference were adversely criticized on the ground that they would weaken the parents' own sense of responsibility. It is curious that this dogmatic confidence in the adequacy of the taboo should have attached itself to a system which was ostensibly based on the all-sufficiency of enlightened self-interest. The ties of family were regarded as so absolute and so fundamental that, for the purpose of enlightened self-interest, the self included the family

The power of taboo in sustaining the obligations of the family is remarkable, but the cases where it breaks down are for all that too numerous to be neglected. The breakdown may arise either from the fault of the parents, or from their want of wisdom or from their poverty. Whatever the cause, the consequences of an insufficient or ill-judged provision for the care of children are so grave that the interference of the State is regarded nowadays as imperative.

It is particularly in the mental and moral upbringing of the children that such interference occurs. In view of the extensive activities of the State in modern times or of the Church in the Middle Ages, in the sphere of education, there is perhaps a tendency to under-estimate the part still played by parental influence. The foundation of human propensities is instinctive and innate, but that foundation is extremely restricted in comparison with the vast superstructure of acquired characteristics. This superstructure includes the rational and half-rational motives of the sub-consciousness as well as the non-rational taboos.

Many of these propensities are acquired in the impressionable years of early childhood. The impressionability of childhood is only a particular case of the impressionability of mankind. To attribute this impressionability to an inherent human quality of imitativeness or to a "herd-instinct" is to make a quite unwarrantable assumption. Such inherent qualities or instincts may exist, but, if they do, they do not tell the whole story, for other and more explicable elements enter into the influence exercised by one human being over the conduct and the standards of another.

Our power of thought has grown up as a means to *action*. Now that it exists, it can be applied to purely speculative and theoretical ends, but it was as a practical instrument that natural selection developed it. It is the function of thought in practical life to foresee and to compare the consequences of alternative courses of action, in order that a considered choice may be made among them.

To perform this function adequately, the mind must do two things: it must think of all relevant alternatives, and it must reason out the consequences of each. Both are difficult, but the former is in some ways the more difficult of the two. Experience goes a long way to help us to foresee the consequences of a given action, though every concrete case contains something new and therefore unknown and doubtful. But experience only helps us in a very limited degree to think of all the alternatives. It can only suggest those courses of action which have actually been tried in

similar circumstances in the past. Yet there may be an indefinite number of others which have never been tried at all, because they have never been thought of.

The power of striking out new ideas, essential as it is to the efficient application of reason to action, is nevertheless one with which human nature is very scantily endowed. The qualities of originality, initiative and imagination are precious and rare, and the average man cannot be expected to exhibit them frequently or regularly. In the practical affairs of life he has to depend on ideas suggested from outside rather than on those springing from his own consciousness. His susceptibility to other people's ideas is therefore the result of a pressing and real need. And he tends not merely to comprehend these ideas but to act on them. An action, so far as it is intentional, is a selection from such alternatives as are in the mind. In general these alternatives will have been suggested either from the man's own former experience or from that of other people. And his former experience itself has been to a great extent suggested from the behaviour of other people, so that the stock of ideas which he applies to meet his practical needs is mainly derived from those people whom he has had the opportunity of observing.

His susceptibility to extraneous ideas depends partly on the number and force of the competing ideas supplied from his own experience. In the case of children these competing ideas are fewer and weaker. At the very start of conscious life they are *nil*. In the later years of childhood some of the results of the experience of mankind can be imparted by instruction through the medium of language, in the form of general principles with suitable illustrations of their application. But to a child language, even for several years after it has been learnt, remains a very crude medium of expression. It is crude enough to most adults, and for some purposes utterly inadequate even to the greatest masters of literary style.

The early lessons of childhood are acquired, not through instruction and precept, but through *example*. And these lessons are not for the most part purposely given. They are picked up from the daily behaviour of parents and others. Language itself is an instance. The baby is confronted with the obvious fact that people are using their power of articulating for the purpose of signalling to one another. The want of making signals or communicating is one which he feels every time he is dissatisfied with anything. The result is that he soon resorts to experiment in articulating, to see

what he can do in that direction. The early years of childhood are full of experiments. Perhaps only the very simplest movements, such as grasping with the hand, are purely instinctive, and even in these many little refinements and complications are imitative.

The action that is imitated often reveals a new end as well as the means of attaining it ; the need and the method of satisfying it are first learnt in the same lesson. As the mind develops, competing needs and competing methods of satisfying a given need multiply. The ideas suggested from outside no longer slip in to fill a vacuum ; they are weighed on their merits, and, if they are to be adopted, must show grounds of preference over those in possession. These latter have the advantages of conservatism on their side. That is not entirely a matter of habit ; indeed against habit must be set the contrary force of the charm of novelty. Conservatism, like so much in human nature, has a simple rational basis.

In demonstrating this we are led to a new set of considerations. The poverty of the human mind's power of originating ideas is only one of the difficulties in the way of the exercise of practical judgment. Another is the extreme liability to error of the reasoning process by which we estimate the results of our actions. So fallible are we, and so conscious of our fallibility, that we distrust every inference that has not been verified by experience. Those actions that we have performed in the past we rely upon ; we hesitate before trying new ones.

But inferences can be tested by other people's experience as well as by one's own. Consequently, even when habits have been acquired and ideas formed, conservatism will not necessarily outweigh the tendency to adopt other people's ideas and actions. The mere fact that someone has elected to follow a certain course of action is evidence *prima facie* that he has found some good reason both for the end sought and the means adopted. That is not conclusive proof that the same course of action would be equally desirable for someone else, who has observed him. But it creates a presumption to that effect, and the presumption may often be strong enough to outweigh the reasons (which may be slight or non-existent) for any alternative course of action.

Reasoning is difficult, and its results are doubtful ; the presumption from other people's conduct offers a short cut to a conclusion. That is especially applicable to children, whose reasoning faculty is undeveloped for want both of practice and of experience.

The foregoing applies not only to *conduct* but to emotion or feeling, upon which conduct is ultimately based. Means are chosen for the sake of ends; the choice of the ends themselves is determined by feeling. Here we come right down to the basis of motive, the very stuff of which human nature is made. Under the general term *feeling* are included alike the appetites and cravings that proceed from instinct, and the manifestations of those sentiments[1] of which character and disposition are composed. Feelings are never wholly acquired from other people; however stimulated and guided by example, the feelings must always proceed ultimately from some individual propensity. Nevertheless the effect of example must be very great. That is partly because a human being can only experience in a lifetime a very small proportion of the infinite variety of feelings of which he might have been capable. The feelings we experience are restricted to the range of the possible objects of feeling presented to us, whether in fact or in thought. And even of the objects presented to us, not all excite feeling. For that it is necessary, not merely that they should be presented, but that our attention should be called to them.

We are extremely sensitive to one another's emotions, sensitive, that is, to the natural expression of the emotions. Both the natural expression of the emotions and our sensitiveness to it may be confidently attributed to the realm of instinct. Indeed there has been much very plausible speculation as to the origin of the modes of natural expression and their parallels among the lower animals.

A man's emotional life consists of a restricted selection from all the feelings that he might have experienced. The selection is only in a minor degree determined by his own volition; to a far greater extent it is imposed upon him by circumstances, and more particularly by suggestion from the emotional experience of his neighbours.

Here, once more, we have a tendency which is especially strong in children. For past experience is the most potent rival to external suggestion in making the selection, and this rival is weakest at the beginning of life, and gathers strength ever afterwards. Sensitiveness to emotional expression is

[1] The term "sentiment" is used by psychologists to mean a propensity which becomes active in the form of an emotion whenever an appropriate object is presented to the mind, and at other times remains in abeyance (see W. Macdougall's "Outline of Psychology," Chapter XVII). For example, if a man disapproves of gambling, he will have a feeling of disapproval whenever he sees gambling or thinks of it, but, when his mind is occupied with other things, this feeling remains dormant, or, in other words, non-existent.

present before speech is even learnt, and long before the understanding of speech has reached such a stage as to transmit the refinements of feeling. In general the earliest emotional experiences of the child, beyond the purely instinctive cravings and distresses, are acquired through observation of the parents; the parents themselves on some occasions are, but on many others are not, exercising conscious influence. After speech is acquired, the influence of example is accompanied by that of instruction and precept, but such are the shortcomings of language that the former probably long remains predominant.

The early impressions, confirmed and continued by the force of association and habit, permeate the disposition and character of after life. They may be dispelled or transformed by self-criticism, or displaced by new enthusiasms, but that is on the whole exceptional. Whatever may happen in people of unusual intellectual or spiritual power, when we are treating of society in the mass, the governing propensities are those which pass, generation after generation, from parents to children. Occasionally, at intervals of several centuries, there comes a mighty stirring. The deepest prejudices and traditions are re-examined and revised in the light of a new inspiration. Such was the advent of Christianity, the Reformation, or the French Revolution.

Under normal conditions it is the function of the family to sustain through the early impressions of childhood this continuity in the emotional life of society. From the most trivial of experiences to the gravest, every event and every action has its appropriate emotional atmosphere. Disgust at dirt, hatred of cruelty, fear of the results of wet feet, respect for clergymen, condemnation of lying, admiration of courage, loyalty to kings, love of freedom, these are random instances of what may be imbibed by the child from the spontaneous manifestations of feeling by the parent. Upon the same influence depend those taboos which play so large a part, not only in the institution of the family itself, but in every branch of morality and custom. The reasoning, sub-conscious or conscious, with which so many of the prevalent motives of human nature are intertwined, is almost as dependent upon parental influence. Human feeling, though not itself intellectual, usually contains an intellectual element, which results from the intimate relation between the feeling and its object. To experience the feeling, it is essential to apprehend the object; and where the object possesses any degree of complexity the apprehension of it is a function of the intellect.

For example, we saw in the last chapter how the love of money arises out of rational considerations of the uses of money. No doubt the love of money, like other sentiments, is imprinted by parental example, but, if the parental example is to be understood, the true object of the sentiment must be appreciated. The child must understand what his father means when he says he has lost half-a-crown, or has had a rise of pay, or when he refuses to buy something expensive.

To appreciate and to share disgust at dirt, the child must understand what dirt is. That is itself a great effort of the intellect, an inductive inference from the various occasions on which the parental scrubbing and sweeping and dusting have been observed. Undoubtedly when he has lapsed from the ideals of cleanliness and encountered his mother's wrath, he will be impressed with the importance of a principle which justifies so much care and trouble and evokes so much feeling. But in order to assimilate the principle he must understand it.

Some objects of feeling are so difficult for the untutored mind (even of an adult) to comprehend that they have to be associated with some symbol or set of symbols, such as the clothes of the clergyman.[1]

It is perhaps hardly necessary to say that influence of the kind which we have just been describing is not limited to parents. It is exerted, not only by all adults with whom children come in contact, but also by other children. And here we may pass to the region in which education can be regulated by *voluntary* action on the part of the parents and of the community. The selection of companionship for children is an example

Voluntary action on the part of the parents cannot be marked out by any clear line from involuntary influence. The effects of the latter cannot fail to be great, but the wise parents are always taking into consideration the reactions upon their children of everything they do or say or express.

More directly voluntary is the influence exercised through parental authority. Children are aware of their own helplessness, and find themselves dependent on their parents for the fulfilment of nearly all their primary needs. Parental authority rests partly upon this state of dependence, and partly upon a taboo, which is inculcated by the parents themselves with the assistance, where requisite, of the penalties approved by the custom of the nursery. It is

[1] Symbols of this kind play a large part in taboos. The object of the taboo must be *unmistakable*. The marriage ceremony supports the family taboos, because it removes any ambiguity as to whether two people are man and wife or not.

hardly necessary to add that, where to these foundations is added the solid basis of natural affection, the power of parental authority is enormously increased.

Parental authority may contribute to education by enforcing rules, which may acquire the force of habit and so regulate conduct ever afterwards. But it has educative effects in another way also. The power of the parents makes their feelings, prejudices, habits, and standards matters of pressing and immediate interest to the child. He cannot afford to neglect them, and thus his sensitiveness to their example is stimulated. As his intelligence grows, he is led to attend not only to their example but to their instruction and their precepts. These he probably accepts unquestioningly, until with the approach of years of discretion he becomes more capable of taking a critical standpoint. The power of authority, however, takes effect not so much in securing his acceptance of his parents' views as in forcing these views upon his attention at a time when he has not sufficient experience or practice in reasoning to criticize them. Even when his critical faculty grows, he still has his parents' views thrust upon him, and, even if he exercises discrimination and rejects some of them, he cannot ignore them, and his mental life is coloured by their passage through his consciousness.

Parental authority can be delegated to others, either to nurses, governesses or tutors at home, or to teachers at school. Whether it is so delegated or not, a stage inevitably arises at which the parents have to decide what kind of instruction, how much of it and for how long, is to be given to their children. A problem of grave responsibility and infinite complexity!

Life is full of such problems, and the individual rarely tries to solve them on his own account. The same problems have presented themselves to his neighbours, and to his and their predecessors and ancestors. He is prone to adopt the solution that satisfied them; in other words, he is guided by custom. But within the limits of custom he has a certain degree of freedom.

The taboos of the family combine with natural affection to identify the interests of the children in the parent's eyes with his own. Ambition to him means a desire for his children's success almost as much as for his own, sometimes even more than for his own. As we saw in the last chapter, the success aimed at by ambition is that which is *recognized* as success. The ambitious parent will seek for his children the training that will fit them for the highest economic

grade in which he thinks he can successfully launch them.

Education is bought and sold in the market, like other commodities and services The more thorough it is and the longer it lasts, the more it costs The more skilled the teachers, the higher their remuneration. As the education of the children is prolonged, the time when they can earn their own living is postponed ; the parents have to pay not only for the children's instruction, but for their maintenance. Thus the parents' ambitions for their children are limited by what they can afford to pay. And the parents' poverty interposes obstacles not only to their material ambitions, but also to their desire to turn their children into excellent and cultured human beings.

The question of the intervention of the State to remedy the injurious effects of poverty upon education we shall turn to later

CHAPTER XV

HUMAN NATURE AND THE STATE

THE authority of the State is supported by organized force But it does not, perhaps it *cannot*, rest solely on force. It usually rests upon the general acquiescence, if not active consent, of the members of the community, force being relied on only in exceptional cases. Force, it will be remembered, we defined in this connexion as "an effective threat of physical injury" (Chapter XI), and the threat is far from being as exceptional as the execution of it The existence of organized force, available for use if required, may so successfully overawe a large number of malcontents that they never actually challenge the authority of the State; the force remains no more than a potentiality, but that is only a sign of its complete efficacy.

But the kind of discontent with the State that has to be overawed by force is usually limited in its objects. The would-be rebels are dissatisfied perhaps with the personnel of a Government, belonging to an alien race or to a restricted class, or they desire a change in the constitutional law, or they complain of oppression or injustice or hardship in some limited field of law or administration. They may be numerous, and may even be a great majority of the community, but in matters outside the limits of their specific grievances they yet may acquiesce in the authority of government without demur, and to that extent government still rests not on force but on consent. Where that is not so, where discontent reaches such a pitch that the malcontents give no more acquiescence in the authority of government, at any point where they meet it, than force can extort, government becomes both ineffective and unstable.

In so far as the authority of the State rests on consent, that consent proceeds chiefly from two distinct sentiments in human nature, *loyalty* directed to the State itself and its representatives, and *respect for law*.

Whoever experiences a feeling must in some way appre-

hend its object. The State in itself is not an easy idea for any but an educated mind to grasp, and the loyalties of primitive man took the form of numerous taboos, directed not towards the State as such, but partly towards his leaders and partly towards his compatriots. The leaders united in themselves the characteristics of both kings and priests. To any one community there might be one, two or several such. They might be regarded as embodying or personifying the State over which they ruled, but that would only be comprehensible to people who have mastered the conception of the State. Any such idea is likely to be a late growth, resembling the mythology by which taboos are so often rationalized and turned into symbolism.

The priest-king was himself the object of taboos, which served the purpose of clearly marking him out from his neighbours, so that there was no doubt to whom allegiance was due. He carried special emblems, such as the crown and sceptre. His actions, not merely those in which he was discharging his kingly duties, but many of those of his daily life, were accompanied by minutely prescribed ceremonies. People might not approach him or address him as they would an ordinary man, but had to make obeisance, and use forms expressive of humility and submission. Rebellion against his authority was a profanation.

A chieftain thus distinguished was responsible, as priest, for officiating in the religious observances ordained by custom. As king he was responsible for leading the people, that is to say, for directing their organized force Whether force was used to impose upon individuals the discharge of their obligations towards the community, or to conduct a conflict with an external enemy, leadership would involve initiative. Other functions might be left to the routine of priestly tradition; those of leadership required adaptation of means to circumstances, alacrity in taking opportunities, ingenuity in outwitting or outmanœuvring an enemy, skill in allotting to each follower his appropriate task in a plan of campaign. The rules of taboo ordained that everyone should obey the leader's commands; obedience to an individual was required instead of obedience to a fixed rule, just because the business of employing force could not be made a matter of fixed rules.

The leader had to *choose* what should be done. If he had to choose, then he might choose wrong. His fellow warriors could not fail to criticize his choice in a matter that might vitally affect their own interests, including life and liberty. To criticize is to rationalize. In opposition

to the unreasoning taboo on which the king's authority rests is set the practical purpose which that authority exists to serve. Out of the conception of that practical purpose grows the idea of the State.

It is often assumed that the State in its origin was an organization solely for war. But on that we have no right to dogmatize. It is quite possible that human communities grew up in the first instance for purposes unconnected with warfare. One obvious alternative is that they may have grown out of the family. But even without any such bond as the family affords, the mere tendency to seek out the places most favourable to subsistence would assemble numbers together. Such concentrations must give rise eventually to a struggle for survival, but there is no reason in the nature of things why the struggle should have been between group and group, rather than between individual and individual

The maintenance of internal order would not try the competence of the leaders so severely as warfare. Primitive law takes the form of taboos. If the State is to work at all, the people must be strongly disposed to conform to these taboos, and from what we know of uncivilized peoples we may safely say that they feel the obligations of their taboos with extreme intensity.

Prominent in early religious ritual is the practice of *sacrifice*. Sacrifice, whether it be the destruction of something precious (possibly human life itself) or the voluntary undergoing of pain, privation or injury, is an expression of intensity of belief in the validity and importance of the system of which it forms part. A man will not slaughter and burn the pick of his flocks and herds, or fast for days together, if he feels doubt as to the obligation to do so.[1] Sacrifice, therefore, works as a test. And in doing so it also promotes intensity of belief. We have already noticed how man, diffident of his own reasoning processes, is prone to accept those of his neighbours. One brought up among people who regularly make the sacrifices demanded of them by religious observance is likely to believe without question in the religious system to which they testify.

But there are bound to be exceptions. Individuals will sometimes be found who wilfully contravene the rules of taboo, not necessarily from any disbelief in them, but on account of rival propensities, passion, greed or self-interest. Then it devolves upon the organized force of the community to punish the delinquent. Punishment, like sacrifice,

[1] This is not true without exception, for he may perform the necessary sacrifices in order to *make his neighbours think* he believes in the system.

is a method of expressing belief in the taboos. Primarily intended perhaps from the very beginning to be a deterrent, it could hardly be inflicted except by those who feel convinced of the validity and importance of the rules which it enforces. Nowadays, though deterrence is the accepted purpose of punishment, its function as an embodiment of moral opinion is of great importance Capital punishment is as it were a celebration by human sacrifice of our belief in the wickedness of murder.

It will be seen then that the leaders who direct the organized force of the community are ultimately, if not immediately, responsible for the administration of justice. However clear and well known the rules to be administered may be, the application of them to particular cases inevitably requires the exercise of some discretion or choice, and he who has to choose may choose wrong. By his choice the interests of individuals are affected; they may suffer directly, by being unjustly punished, or indirectly, through criminals who threaten their interests being unjustly let off.

And their injuries may go further. For the chieftain, relying on the power of taboo, may misuse his privileges in his own interest. His authority is itself limited to what religious custom prescribes, at first limited so narrowly that such discretion as he can exercise is hardly discernible. But as circumstances arise necessitating the exercise of discretion, the limitation becomes less effective. The chieftain may use his power to get for his own enjoyment or aggrandizement an undue portion of the community's resources, or to gratify his own personal feelings, favourable and unfavourable, towards individuals.

Whenever he chooses any course of action, it becomes possible for a critic to say that either the end or the means chosen was mistaken. The rationalizing process which grows out of such criticism is applied therefore to both ends and means. From it spring the two sentiments we have named, loyalty to the State, and respect for law. These sentiments in so far as they are rational, do not rest on taboos. A great part of history is composed of the gradual displacement by them of the primitive taboos, but the displacement has never been *complete*. And new taboos persistently come into being in support of rules, which, originally rational, gain general acceptance without a full or universal or lasting appreciation of their rational basis.

Loyalty to the State, when it becomes distinguishable from loyalty to the king, involves a conception of the public interest, the common advantage of the community as a whole.

This conception takes shape most clearly in war. In war the organized forces of two different communities are in conflict with one another. Each opposes to the other the effective threat of physical injury, till one of the two makes submission; or both, because success seems unattainable at any rate without undue risk or sacrifice, acquiesce in a compromise If the disparity of force is so great that the result is a foregone conclusion, there is no purpose in fighting.[1] Whatever results the stronger could get thereby can be got by the voluntary agreement of the weaker; the threat is effective without having to be actually executed.

When resort is had to fighting, and each side endeavours to carry out upon the other its threats of physical injury, each has to suffer indefinitely at the hands of the other It has to suffer the wounding or death of some of its members and the destruction of some of its material possessions. The issue is reached when one side has proved its power to inflict such harm as the other cannot endure. It is the *expectation* of further injury that leads the beaten party to give in. The injuries actually inflicted contribute to the result in so far as they may have weakened the beaten party relatively to the victor. But their chief significance is really as evidence of the victor's power to inflict *further* injuries. It may even happen that of the two the victor has been the more weakened by losses, but yet has proved his preponderant power for harm.

Where the combatants are of approximately equal strength, the amount of loss and injury which each must sustain before the result has become clear may be very great. It might be supposed that no community would resort to war, and run the risk of so much harm, except for an object of vital importance. But that is not so. Wars are constantly fought, and have been fought all through history, for apparently trifling and almost frivolous causes. The readiness of mankind to fight is often attributed to an instinct of pugnacity. Indeed to throw doubt on the existence of such an instinct would be regarded as an extreme of paradox But here, as elsewhere, we shall be well advised to be cautious in assuming congenital instincts as the explanation of human behaviour, till we have explored the ground, and discovered how much is left to explain, after the effects of other causes have been traced. Even if the instinct of pugnacity exists,

[1] Though even then the weaker party may gain something by threatening to resist, for the stronger may make concessions rather than be put to the trouble and loss of actually subjecting the weaker.

it is not necessarily one, like those of sex or fear, so potent as to sweep away reason.

Suppose a number of human communities to exist, each occupying its own territory, and enjoying whatever resources and advantages the territory furnishes If any two of them quarrel, the victor will probably make the vanquished give up something—perhaps actual territory, perhaps some rights or privileges of value. The power of a country for war depends not only upon the numbers, skill and courage of its people, but also upon its material resources. If a successful war increases these material resources, the country will be made thereby more powerful for a future war. After a war of exhaustion even the victor, it is true, may be left weaker than before But the exhaustion can be remedied by time, while territorial gains may bring a permanent increase in resources.

It is still more likely that the defeated party will be permanently weakened. Like the victor it will recover from the immediate exhaustion of the conflict, but a permanent diminution in its resources will still leave it less able to meet any future enemy. The nature and extent of the losses that can be inflicted on a country defeated in war vary according to the customs of the times. If the conqueror massacres and enslaves the conquered people, he can practically enter into vacant possession of their territory with all its natural advantages The defeated party ceases to exist as a State. Without going so far, the conqueror may annex all or part of the conquered territory. In that case the population of the annexed territory may either be subjected to the authority of the conquering State, and compelled by force, in so far as they do not consent, to obey it, or they may be absorbed into the population of the conquering State and assimilated to it.

Or again, without any formal annexation, the government of the defeated State may acknowledge its subjection to the conqueror, and may be allowed to continue in existence, possibly making a periodical money payment by way of tribute, or undertaking to support the conqueror in war against any future enemy.

All these methods are likely to increase the future power of the conqueror (though sometimes the annexation of an embittered and unwilling alien population is a source of embarrassment or weakness rather than of strength), and the result is that warfare tends on the whole to make the strong stronger and the weak weaker.

Every State that is exposed to the risk of war is therefore

in an unstable position. Once let it be proved weaker than a neighbour, and it will be despoiled and the disparity of strength will be indefinitely increased. The despoiling is not necessarily done in war. The stronger State, if its superiority is admitted, can extract concessions from the weaker by diplomacy. Diplomacy, except where it is coloured by international idealism, is simply war without the fighting; like war it makes the strong stronger and the weak weaker. If the strongest power is left free to encroach on its weaker neighbours unchecked, it will establish a hegemony. Military power, however, is subject to certain limitations; more particularly it is dependent upon communications, and the force that can be exerted against an enemy diminishes as the distance from the base of operations grows greater A relatively weak power may thus be safeguarded by distance from one that is far stronger. Diplomacy is a faithful enough mirror of war to reflect these potential military advantages and disadvantages. Consequently even so vast a hegemony as that of the Roman Empire eventually stopped short, and established frontiers with powers in themselves far inferior. The interposition of the limit is very much a question of internal communications. The exceptional extent and solidity of the Roman Empire were only made possible by the thoroughness of the road system constructed throughout the Empire, together with the advantage of sea communication throughout the Mediterranean. For want of these advantages the conquests of Alexander the Great before and of the successors of Mahomet after quickly fell to pieces.

On the whole however, an unchecked hegemony, even within an area of adequate communications, is the exception Rather than remain at the mercy of a strong neighbour, the weaker powers will combine together in a military alliance, and establish a balance of power. If an aggregate of states is divided into two or more groups, each so bound by alliances as to be practically a unit for purposes of war, and if the several groups are so nearly equal to one another in power that it is not possible to say with any confidence which would get the best of it in a war between two of them, then so long as matters remain in the region of diplomacy the groups can bargain with one another on equal terms.

When we speak of the "prestige" of a State or group of States, we mean the reputation for power on which it can rely for the purposes of its diplomacy. Primarily prestige is based upon the prevalent opinion as to the State's military power. That opinion is affected however, by the actual degree of diplomatic success that the State achieves, for this

success depends very much on its representatives' own opinions as to its military power. When they give way, that is interpreted as a sign of weakness. It means that the State itself is not prepared to use the threat of force up to the limit at which actual force may be necessary. If its military power is known beyond doubt to be adequate, its prestige may not suffer. But where there is a balance of power that condition is not satisfied.

Some countries are so placed that their prestige is of small consequence to them Some for example are in too isolated a position to be easily open to attack Some, though utterly inferior to big neighbours in power and resources, nevertheless do not have to depend on their own defence because no one of the big neighbours will let another encroach upon them. Others again are safe because there is nothing in the local advantages of their territory to tempt an aggressor

But none are quite indifferent to prestige. No set of circumstances can absolutely safeguard a country which is completely defenceless. And in general people attach the highest importance both to their country's prestige and to the reality of military power upon which it rests. This is another particular case of the love of power, and has the same rational basis that we have already indicated. The power, once gained, *may* be the means to an indefinite number of advantages ; the lack of it may be the cause of an indefinite tale of evils. Indeed a country which has much to lose, and which is within reach of stronger neighbours, is on the edge of an abyss. Even if the disparity of strength is not decisive, they will be tempted to seize any opportunity that may arise of attacking it and establishing their superiority. Thereafter the disparity will have become decisive and they can despoil it at their leisure

Thus people desire power or prestige for their country in much the same way as they desire money for themselves ; they see in it something of which the value as a means is certain, even though the difficult question of the ends to which it is to be directed is left vague and unsolved. It is equally certain that the lack of it will expose the community to dangers all the more tremendous because they are incalculable and therefore illimitable.

War is a trial of strength ; it is only resorted to at all because there is some doubt as to which combatant is the stronger ; therefore neither combatant can afford to leave any part of his resources unused. Those members of the community who appreciate the significance of war derive from it an overpowering obligation, imposed upon themselves

and all their fellow countrymen without exception, to place their services and their property at their country's disposal.

The taboos of kingship, if maintained in their pristine perfection, imposing an absolute duty of obedience to the leader, could secure the universal acceptance of this obligation But as they are rationalized away, a new sense of obligation has to be created. It emanates from the process of rationalization itself. And rational though they are in origin, the duties of patriotism become embodied in a new set of taboos. The individual is brought up to believe in his duty to his country as something absolute; because it is not derived from reason, therefore it is above criticism.

Were patriotism allowed all it claims, it would override all other human ends. No rules of taboo could impose upon ordinary human nature an unreserved recognition of so sweeping an obligation. But those responsible for exercising the authority of the State and directing its organized force will feel the need for a universal acceptance, at any rate of the most essential duties, by the members of the community. Where this acceptance is not given voluntarily the authority of the State may be employed to enforce it by penalties, and to compel the rendering of the necessary services. Able-bodied men may be compelled to serve under arms; property may be requisitioned.

As a rule the members of any country, though they are not prepared to sacrifice all other ends unquestioningly to their country's prestige and power, will yet without compulsion give considerable weight to the obligations of patriotism in guiding their conduct. In the normal man patriotism is a deep-seated sentiment. But what is the exact meaning of his "country," which is the object of this sentiment? Perhaps in its earliest phase it meant those of his fellow men who observed the same taboos as himself. One of the functions of taboo is to distinguish compatriots from strangers. Compatriots who do not observe the right rules incur penalties Strangers have a different set of rules at home, and cannot be expected to conform to a set with which they are not familiar. Allegiance towards the king-priest, which is one of the requirements of taboo, has a special importance in that it is the bond which actually secures organized action, especially in war, by the community.

When the allegiance of taboo makes way for a rationalized patriotism, the object to which patriotism is directed is the community composed of people with a common allegiance.

Each of these individuals is regarded by himself and by all the others as bound to participate in the common action of all, and more particularly in the common action necessary in war. The mutual recognition of this duty distinguishes them from other people

Conquest brings with it the subjection of people with different taboos, and with different allegiance. Allegiance apart, the differences can be tolerated ; indeed a wholesale alteration of the taboos to which the people are accustomed would be utterly impossible. The duty of allegiance, however, is a special case.

So long as the members of the conquered community regard themselves as bound by allegiance to their own leaders, subjection, however thorough for the time, is yet incomplete It may be possible to induce them voluntarily to transfer their allegiance to the leaders of their conquerors, and in that case they may be simply absorbed into them. Or the conqueror may use his own force to impose upon the conquered by compulsion the duties of patriotism towards his own community, even to the extent of exacting military service from them. Under these conditions the conquering people form a dominant caste. They are distinguished from the others in that they are credited in the national organization with a voluntary sense of obligation towards the community, while the others cannot be relied upon unless coerced. Where such a dominant caste exists, the passage of time often wears away the distinction; unless there are insurmountable obstacles of race, religion, or language, the subject peoples gradually acquire the sentiment of patriotism, and are eventually admitted to equality The sense of obligation is fostered by the sacrifices demanded in the name of patriotism.

Almost every phase of conquest and its after-developments is to be found well illustrated in the history of the Roman Empire. The Romans started with priest-kings, but, with the awakening of their political consciousness, they turned the kings out, and thenceforward their primitive allegiance was displaced by a powerful taboo *against* royalty. Under the Republic government was always in the hands of a caste, first of the patrician caste, then of the official or senatorial caste. The governing caste was first purely Roman, then Italian, and finally it began to embrace other nationalities. As conquest extended east and west round the Mediterranean, the problems of organization became more and more difficult. The territories acquired were held in varying degrees of subjection ; some were assimilated,

some were treated as mere provinces, some were kept on the footing of allies. The defect in the later years of the Republic was the very great and irresponsible power put in the hands of the political governors and military commanders exercising authority in different localities. They made use of their authority to further their personal ambitions, and the result was that just when the union of the entire Mediterranean basin in a single rule had for the time being eliminated the possibility of serious international war, civil war on a great scale became chronic. The only possible solution was found in a monarchy. But a revival of the old taboos of kingship was still impossible, and the new monarch was constituted by the union of the taboos attaching to a number of separate offices of authority. He was President of the Senate, Chief Priest, Tribune of the People, and Commander-in Chief. To each office a certain sanctity belonged, and he who held all was placed in a position of unchallengeable power.

This new taboo became the bond of union of a multitude of pagan communities at a time when their local taboos were being progressively weakened by inter-communication. Obligations which were burdensome and sometimes horrible could not fail to be challenged by anyone who had travelled to places where they were unknown or disregarded. The practical problems, political, social and economic, raised by the organization of a vast Empire, provoked an activity of mind which hastened the process of rationalization. The mythology which we associate with paganism was a passing phase of this rationalization. The fancies of poets could not long survive except as poetry.

And thereupon there supervened a new form of rationalization. Theological religion, which found a metaphysical meaning in the rules of taboo, had long existed in the East. It existed in Persia and in Egypt, but above all among the Jews. And the Jews were not a tiny community of priest-ruled fanatics living the simple life among the hills between the Arabian desert and the Mediterranean. Their intellectual inheritance was to be found among the proselytes, the numerous, active, wealthy population of Phœnician traders, distributed in every commercial centre of the Roman Empire. These were the Jews of the Dispersion. The new theology started among the Jews of Palestine, and soon was in acute conflict with the Judaism of the Dispersion, as well as with the other Oriental religions, the cults of Mithra, Baal and Isis And it came in conflict with the State.

The Emperor was officially designated sacred, divine, a god. To anyone whose conception of these attributes is coloured by Christianity, the claim seems monstrous or childish. But it is an anachronism to read into the godhead of the Emperor the doctrines of a philosophical theology. In reality it meant no more than that the Emperor was taboo. He was to be an object of worship, but the pagan was accustomed to objects of worship with no ulterior significance. The worship of Divus Cæsar was not fundamentally different from the deference and awe commonly shown in modern times to Kings and Popes.

But to the Christian nothing was divine but God, and nothing might be worshipped but what was divine. His taboos had a deep philosophical significance, and were interwoven with the fundamentals of morality. The great persecutions were the result.

At last the Empire itself became Christian, and Christianity compromised, so far as was necessary, with the pagan taboos. The problem of authority arose again among the barbarians who swept away the rule of the Empire in Western Europe and in Rome itself. Two forms of authority came into being. On the one hand rulers like Charlemagne, who sought to exercise an extended hegemony, expressed the nature of the authority they claimed by calling themselves Cæsar or Emperor. On the other the Christian priesthood was invested with sanctity by the taboos of Christianity itself, and exercised authority in virtue of that sanctity. But neither authority could command such implicit assent as had enabled the heads of the unimpaired Roman Empire to govern. Popes and Emperors were in continual conflict with one another. Of the two the Popes were the more successful in establishing their authority, and for some purposes Christendom was a political reality. Nevertheless neither Popes nor Emperors were ever really in a position to control the innumerable territorial authorities by whom the immediate duties of government were in practice discharged. Among these there set in the same tendency to aggregation which had formed the Roman Empire. But its result fell short of a complete unification of Europe and left a set of mutually independent States, some very large, some relatively small, whose relations have since been regulated on the principle of the balance of power.

In present-day Europe the system of government by a dominant caste has been to some extent displaced as a result of democracy and of the principle of nationality, but it is still to be found among the mixed nationalities of Eastern

Europe. It has been imposed outside Europe in its most uncompromising form in those dependencies where the authority of government is exercised by European communities over Asiatic or African populations. The consequences to a subject population of the ascendancy of a governing caste are not necessarily very injurious But it is usually taken for granted that the governing caste will use its power in its own interests. The authority of government can be used in a great variety of ways for the advantage of those who exercise it, and their gain is likely to be in many respects the loss of those whom they govern.

On the whole human communities have good reason to fear conquest, and, if no other method is available, to arm themselves against it. On the other hand the greatest wisdom of the conqueror is to be found in leniency. In proportion as he is harsh to his victims they will be tenacious in their resistance. The prospect of favourable treatment will tempt them to yield rather than incur the illimitable sacrifices of warfare.

We still have to examine the sentiment of respect of law. In the very earliest stages this could be no more than a disposition to obey the rules of taboo, for no other law was known. The separation between those rules which are enforced by the authority of the State and those which are left to custom and tradition is an incident of rationalization. The leaders of the State in virtue of the discretion they exercise are almost compelled to think for themselves, and they will take the trouble to enforce by penalties those rules which appear, apart from their sacred character, also to serve a useful purpose. Respect for law, having for its object the rules so selected, has a rational basis. Once it exists, the scope of the law can be extended beyond the rules of taboo which have a religious origin, and new laws can be instituted on purely rational grounds, as the means to definite ends.

It is hardly necessary to say that the respect for law will not be purely rational. If the State is to rest broadly on consent, consent must be forthcoming from many people who do not give a moment's thought to the rational basis of the laws they obey. In so far as it is non-rational, the respect for law is of the nature of a taboo. Like many of the rules of taboo which prevail among civilized men, it grows up from a rational origin, only to lose its rational character in the minds of many of the people who are influenced by it. The practice of inflicting punishment on breakers of the law intensifies the respect for law, not only

by its directly deterrent effect, but also by affording evidence of the importance of the law itself.

There are, however, always limits to the respect for law. In the most primitive communities legislation is limited to slight departures from pre-ordained custom. A big innovation would be disavowed and disregarded. As legislative activity grows, the limits within which obedience can be counted on to new laws are extended, but at the same time criticism becomes more prevalent among the reasoning members of the community. They are disposed to withhold obedience not so much from laws which make too great changes as from laws which conflict with their views of justice or their social ideals. Laws, if they are to command respect, must conform broadly to the morality of the people.

If any solution of the economic problem necessitates a change in human institutions, legislation is the principal instrument for bringing that change about. If the legislation must be suited to human nature, that means no more than that the solution itself must be suited to human nature.

CHAPTER XVI

WEALTH AND VALUE

It is the generally accepted opinion of economists that the subject matter of Political Economy is Wealth. According to Marshall, " Economics is, on the one side, a Science of Wealth ; and, on the other, that part of the Social Science of man's action in society, that deals with his efforts to satisfy his wants, in so far as the efforts and wants are capable of being measured in terms of wealth, or its general representative, i.e., money." [1]

Wealth is a class of things included in the wider class of " goods." Goods are those things which satisfy human needs. The sub-class wealth, is composed of those goods which are exchangeable or *marketable*, and therefore excludes on the one side things which cannot be transferred from one person to another, and, on the other, things which, though they could be so transferred, are obtainable in such plenty without effort that no one will find it worth while to offer anything in exchange for them.

According to the best-established usage the term Wealth is limited to marketable goods which can be accumulated and possessed, that is to say, to material objects. But the subject matter of political economy as defined by Marshall includes man's efforts to satisfy his wants, in so far as the efforts and wants are capable of being measured in terms of wealth. That is to say, besides marketable material objects, the subject includes marketable *services*. Services cannot be accumulated. But while they cannot form part of capital they can form part of income.

Wealth is not identical with what we have called " products." Products are the results, material or other, of human effort. But some forms of wealth, for example undeveloped land, exist independently of any human effort. And on the other hand there are many results of human effort which, because they are not marketed, do not count as wealth.

[1] " Principles of Economics," p. 101.

A man's efforts for his own gratification, and a wife's services rendered to a husband are obvious and familiar examples.

No definition of wealth, however, is rigidly confined to things actually bought and sold. Wealth means not merely things marketed, but things marketable.[1] The definition is therefore based not entirely on fact but on hypothesis. That is in part the explanation of the plentiful crop of paradoxes that is yielded by its intensive cultivation. Marketability is in many cases an accidental attribute of a class of goods. To make marketable things the subject matter of political economy is to accept an arbitrary and misleading limitation. The market is an important and widely prevalent institution. But it is no more than a piece of organization. It is possible that Society might dispense with it; and it is certain that some of the very ends that are achieved through its means in some circumstances are obtained without it in others. In our definition of the economic problem we have avowedly discarded this limitation, and we are therefore not concerned in the paradoxes to which it gives rise.

The concept of wealth, before it was ever employed by economists as the subject matter of their study, had for ages past taken a prominent place among the ideas of mankind, more especially among those relating to practical affairs That was because the institution of the market, from which that of wealth is derived, had been from time immemorial an indispensable piece of social machinery. People had become accustomed to measure their possessions by the test of the market. In so far as their possessions took the form of money or of pecuniary rights or interests, they had no significance except as giving command over wealth—over so much wealth as that amount of money would buy in the market.

Adam Smith and his successors set out to dispel the popular notion that wealth consists in money. That notion Adam Smith traces partly to the use of money as a measure of value, in virtue of which "we say of a rich man, that he is worth a great deal, and of a poor man, that he is worth very little money. . . . Wealth and money, in short, are in common language considered as in every respect synonymous."

Marketable things certainly constitute a definite class of goods, and one quite distinct from money. But when we

[1] It also includes products made to the specification of an individual, which are not marketable because they would not suit other tastes, but which are paid for through the market and would commonly be taken at replacement value for the purpose of arriving at an aggregate of wealth.

pass on from the idea of a *class*, to that of an *aggregate* composed of items expressed in a common unit, and capable of being added one to another, we are at once driven to ask what it is that this unit measures.

The price of the same thing differs in different markets and in the same market at different times. That which price measures must therefore be a quality that is relative to the market in which the thing priced is or is deemed to be bought and sold. A quantity of wealth at a given time and place is measured by its money value. It can only be compared with a quantity of wealth at another time and place if the currency units in which the two quantities are measured can be themselves compared. If we ask what it is in the currency units that has to be compared, the answer can only be their value in terms of wealth.

If the same commodity is dealt in in both markets, it affords a basis of comparison, for it is priced in both currency units. But if the relative prices of different commodities differ in the two markets, each commodity will give a different result for the ratio between the values of the two units, and there is no ground to select one commodity rather than another as measure. Recourse has been had to measurement by index numbers. The money value of a representative selection of commodities is calculated in one of the two markets, and then compared with the money value of the same selection in the other market. Such devices have great value in monetary theory as giving guidance in the control of credit. But they cannot be accepted as giving an absolute measure of wealth, because no selection of commodities can be absolutely representative. If it is representative of one market, it is not representative of another, and the divergences between the two can only be reconciled by a compromise, which has no intrinsic validity. The problem becomes particularly baffling if some commodities which are important in one market are not dealt in at all in the other.

For purposes of currency regulation an index number is needed to reveal certain tendencies towards an increase or decrease in the general level of prices. The problem is a practical one. The tendencies in question have undesirable consequences and that index is best which best enables us to avoid those consequences.

For a theoretical measure of wealth a practical test of that kind will not serve. A solution has sometimes been sought in the principle that price tends to be equal to cost of production. Wealth, it is said, is that which is created by

human effort, and the quantity of wealth can be measured by the amount of effort required to create it. Price often does not measure effort accurately, but that may be because price is only an approximate measure of wealth.

But the amount of effort required to produce a given thing varies widely. And, however fallible the market may be, there is one feature of its measurements which it is essential to retain ; exactly similar things in the same place and at the same time must count as equal in reckoning wealth. They must count as equal, even though they cost unequal amounts of effort.

It is such inequalities of cost that go to make economic rent. Economic rent can be regarded as a *scarcity value* of material things which aid production or help to satisfy needs. A system of measurement of wealth based on cost must take account of such scarcity values. Professor Cassel, among the comprehensive generalizations which he embodies in his theory of the determination of prices, includes what he calls the " principle of scarcity." He would define the field of economics to be the means of satisfying wants, where " the means are scarce relatively to the wants." [1] From this standpoint effort itself is " scarce," for the supply of it is limited, and the principle of scarcity therefore covers all elements of cost.

But this is to abandon effort as the measure of wealth. Professor Cassel's principle of scarcity is introduced as a necessary condition of value, that is to say, of price. But though it is a necessary condition, it clearly cannot be that which price measures. Scarcity is *relative*, it is relative to needs. If price measures some quality which can be *aggregated* when we add products together to make a quantity of wealth, we must seek that quality in the needs which the products satisfy.

Economists treat wealth not only as their subject matter, but also as in some sense the *end* of economic action. This does not merely mean that men do in fact seek wealth ; that would be a proposition of psychology. Economists are not content to leave it so ; they do not affect to be indifferent whether wealth or poverty is the preferable state. Rather they insist that wealth not only is, but ought to be sought, and therein they enunciate a proposition of *ethics*.

If wealth is the end, there must be some quality in wealth which justifies its being selected as the end. It may be taken as a postulate that an end of human action must be a *state of consciousness*. When therefore we speak of wealth being

[1] " Theory of Social Economy "(p. 7 of English Edition).

an end, we cannot mean that the actual marketable objects themselves are an end. The true end must be the states of consciousness arising out of these objects. Accordingly the classical economists attributed to wealth the quality of *utility*. The observed facts of the market were the *preferences* shown for one object over another. Whenever a man offered one thing in exchange for another, it was to be presumed that he preferred what he received to what he gave. The preference was deemed to be based upon some preferable quality, and it was this quality which was named utility.

It was Jevons who first formulated a clear theory of the relation between utility and price. When a man pays money for a thing, he is showing a preference for that thing over any others upon which the money might have been spent. This preference is affected by the supply[1] he already has of the thing in question. The more he has, the less will be his desire for a further supply, and the lower therefore will be the price he will be willing to pay for it

Suppose that the price of sugar rises from 6d. to 8d. a pound. A man who used to buy a pound a week when the price was 6d. must either buy less sugar or will have 2d. a week less to spend on other things. Probably, on the average, consumers will do something between the two. Suppose that he reduces his weekly consumption of sugar to 14 ounces, costing 7d. What is the significance of this change? It means that, on a comparison with other things, the extra two ounces of sugar were worth buying at the rate of 6d. a pound, but not at 8d., while the other 14 ounces were worth buying even at 8d. The first 14 ounces a week are more precious to the consumer than the next two, and the more he has to curtail his consumption, the higher the price he will be willing to pay. If the commodity were one absolutely necessary to life, the consumer would be willing to offer any price he could command rather than go without it, and yet, if the same commodity were plentiful, the actual price he would pay for an addition to his existing supply might be very small or might even be *nil* (e.g., for water, where a natural supply of water is abundant and readily accessible).

It follows that the prices paid by a man only measure his preferences in respect of a small *change* in the supply of each of the commodities that he buys. Jevons distinguished

[1] "Supply" here means supply *per unit of time*, except in the case of durable commodities, which are preserved unchanged while they are being enjoyed or used. For these latter the enjoyment per unit of time is proportional not to the fresh supply acquired but to the accumulated stock.

between the utility of the *total* supply of any commodity received by a consumer, and the increment of utility derived from a small *addition* to that supply. The former he called "total" utility, and the latter he called "final" utility, though it is now more usually called "marginal" utility.

The more the consumer acquires of any commodity, the lower is the utility per unit of any further supply; he goes on buying till the marginal utility has so far fallen as to be balanced by the market price (i.e., by the marginal utility of other things that might be bought with the same money).

The utility of every portion of the supply that he buys before he reaches that point is greater than the marginal utility. If we measure an aggregate of wealth by its market value, we do not measure its total utility, for we value the whole supply at a price which measures only the marginal utility, and the result is something less than the total utility.

If utility is the end of economic action, then economic action should be so directed as to make total utility a maximum. Any *individual* consumer who seeks to secure the maximum of utility from his income will so direct his expenditure that the marginal utility will be as nearly as possible the same for all the commodities that he consumes. For if the marginal utility to the consumer for one commodity were greater than for another, the total utility of the two together could be increased by buying more of the former and less of the latter. Thus marginal utility tends to be a determinate amount for each consumer, in so far as he regulates his expenditure in a rational manner. A halfpenny means the same amount of utility to him whatever he spends it on.

But what of the utility enjoyed by two different consumers? There can be no direct comparison between their respective preferences, and in reality this invalidates the whole claim of utility to be set up as an end for the joint action of several people. A further assumption is needed to make the case even colourable. It may be assumed for example that the two consumers are similar in their capacity for enjoying utilities. On that assumption, if a given amount of income has to be divided between them, the total utility will be greatest when the amount is divided equally. For if one has a bigger income than the other, he can consume more of everything, and the marginal utility will be less for him than for the other. If their incomes are equalized by a transfer from the richer to the poorer, the utility of what the one loses will be less than the utility of what the other gains.

In these calculations the quality of utility is assumed to be the ground of the consumer's preference for one thing over another. The psychological fact, however, is not the utility, but the preference, or perhaps we should say the *choice*. The choice does not necessarily presuppose a definite state of feeling that could properly be designated a preference. Still less does the preference, where it occurs, take the form of an estimation of the relative intensity of some specific quality, such as utility purports to be, in the things among which choice has to be made. In fact the quality of utility is an abstraction. The economists recognized the crudity of the idea of wealth as an end of action. But to reject it altogether would have seemed the height of paradox. Therefore they refined it away, and put this quality of utility in its place.

The establishment of utility as the end was closely connected with the cult of individualism. Individualism relies on the preferences of the individual, as recorded in market price, to supply the motive power of economic action. If these preferences were always directed towards attaining the maximum of utility, that meant that utility was the end *actually* adopted in the individualist solution of the economic problem.

Those who set out to expound the economic system were not bound to accept the end so adopted as the right one. But the pioneer economists were more interested in explaining how the system worked than in criticizing it. In their enthusiasm they were not disposed to admit defects, which might appear to be defects in their explanation as much as in the system.

They were supported in their views by the philosophy of their day. The utilitarian philosophers of the 19th century were hedonists; they believed that the right end of all human activity was pleasure or happiness. One section of the school held the rigid doctrine known as psychological hedonism; they taught that the pursuit of the maximum probable excess of pleasure over pain was inherent in the human will. Not only was this the right end, but man was congenitally incapable of pursuing any other. Those who did not go so far as this still held that man, if left to himself, was on the whole disposed to seek his own happiness. The moral code and the law were necessary to prevent one man from interfering with another's happiness, but subject to those limitations the utilitarians argued that the maximum of happiness was likely to be attained through the maximum of freedom.

The economist applied this general principle to the particular case of economic activity. The consumer's preference would be exercised in the direction of his own greater happiness, and the best way of directing economic action to this end would be to leave him free. Admittedly the consumer might make mistakes. Even the doctrine of psychological hedonism allowed that there might be mistakes as to the right means for attaining the end. But the mistakes were to be best corrected by the spread of instruction and enlightenment; rarely would it be possible to get a better result by external interference.

Utilitarianism was a philosophy of practical aims. Its mission in the 19th century was to apply systematic thought to an incoherent tangle of ill-judged and unnecessary limitations on human freedom, which had long survived whatever usefulness they might originally have had. Part of the case against these limitations on freedom was that the individual could judge what was good for himself better than any Government. This argument was applied above all to economic activities, and if an economist had himself presumed to criticize the consumer's preferences he would have cut the ground from under his feet. If such criticism was justifiable, why should not the Government, with access to all classes of expert opinion, follow it up and act on it? Accordingly, by a self-denying ordinance, they abstained from criticism, and adopted the same attitude of rigorous impartiality towards the consumer's inclinations and preferences as they recommended to all Governments. The consumer expresses his preferences in the prices he offers, and the things he chooses are thereby constituted ends. He knows best what he wants, and no one has the right to challenge his choice.

This detachment from criticism, though it may be a salutary example for a meddlesome Government, does not really correspond to the normal attitude of any human being, and particularly of any seeker after truth, towards his fellow men. To many people it was attractive because it seemed to dissociate economics from ethics. Although it might be justified by an appeal to utilitarian ethics, it could, on the other hand, equally well be defended as a disavowal of any system of ethics whatever. Ethics is a subject as big as economics and more controversial. Economists are proud to claim that theirs is the most exact branch of social science. The intrusion into it of the vexed questions of ethics, with the vast amorphous phantoms of metaphysics looming in the background, would soon make an end of that claim.

Even those who adopted the utilitarian system of ethics believed that this was not like other systems. It seemed rather to be an escape from all the doubts and obscurities of philosophy into the realm of plain common sense.

But economics *cannot* be dissociated from ethics. Those who say that wealth or utility is the end of economic action are committing themselves to ethical propositions, which are open to challenge and need to be defended and justified. Professor Pigou, in the opening chapters of his *Economics of Welfare*,[1] defines economic welfare as "that part of social welfare that can be brought directly or indirectly into relation with the measuring rod of money." "Though no precise boundary between economic and non-economic welfare exists, yet the test of accessibility to a money measure serves well enough to set up a rough distinction."

The purpose of the distinction is to separate off that part of welfare where "there is present something measurable on which analytical machinery can get a firm grip." He points out that a cause which affects the total of economic welfare so defined will not necessarily affect the total of social welfare to the same extent or even in the same direction, but he insists that there is a *presumption* that any gain or loss of economic welfare will be a gain or loss of total welfare, and that the presumption holds unless there is positive ground for upsetting it.[2]

When he turns to consider the nature of economic welfare, he discards the term utility, and draws a distinction (and a pertinent one) between the intensity of the consumer's desire for anything and the amount of *satisfaction* that he eventually gets from it. The consumer's preferences are determined by the *desiredness*, which may differ materially from the satisfaction.

Satisfaction so defined does not pretend to be anything but a revised edition of utility. It remains an abstraction from the consumer's preferences. The difference is that it has to be measured not by what the consumer does pay, but by what he would pay if he foresaw accurately the degree of satisfaction he is to receive.

In identifying welfare with satisfactions, Professor Pigou is implicitly assuming in the individual a disposition to prefer the greater good, just as the hedonist assumed a disposition to prefer the greater pleasure. The former assumption is no closer approximation to the truth than the latter, and we cannot adopt it. We must reserve our freedom to say whether and to what extent any particular kind of satisfaction is to

[1] Page 11 of Second Edition. [2] Page 20.

be regarded as welfare. Welfare here is an ethical term ; it comprises those things in human life, or, perhaps we should say, those experiences, which are good in themselves, and which therefore ought to be chosen as ends of action, economic or other. It must not be regarded as confined to material well-being or as subject to any similar limitation. It is co-extensive with the simple concept "good" as applied not to means, but to ends.

Welfare so defined is not amenable to the "measuring rod of money." Its measuring rod is something distinct from money, distinct from utility, distinct from satisfaction ; it is *value* in the ethical sense. Ethical value as applied to products, is not very far removed from what the economists call "value in use," if that idea be dissociated from the utilitarian philosophy. The "use" of any product is to be found in some experience of which it is the vehicle to the consumer who uses it. To the extent that this experience is good the product has ethical value.[1]

We are speaking here of experiences which are good as ends or in themselves, in contradistinction to actions, or rules of conduct, which are good only as means. The distinction is familiar to philosophers, and is fundamental in ethics.

Taboos elevate rules of conduct into ends. Some philosophers, finding in their own minds an intense belief in such rules, which appear to be independent of their value as ends, have built systems of ethics upon them. Hence have been evolved the systems of the intuitionist school.

If the intuitionist method were pushed to its logical conclusion, and all actions had to be judged as ends and not as means, the result would be that welfare would consist solely in doing certain actions, and that the consequences of an action, except such immediate consequences as formed part of the description of the action itself, would be irrelevant. The economic problem therefore would not arise. Probably, however, an intuitionist would never go so far. While accepting some rules of conduct as ends in themselves, he would nevertheless allow some ends which are not rules of conduct, and would thus admit our conception of welfare.

We do not want our exposition of the economic problem to be bound up with any particular system of ethics. But in

[1] Value in exchange or market value we have already considered in Chapter III. It is a *relation* between commodities, derived from the operations of the market, and is entirely distinct from ethical value. Mr. Dibblee, in his *Psychological Theory of Value*, is really analysing the motives which go to make up market value. Ethical value takes its place among these motives.

a criticism of the ends of conduct how is that to be avoided? The difficulty is not quite so great as appears. For every system of ethics aims at providing an intelligible interpretation of the common ethical judgments of mankind. If the conclusions of the system clash with these judgments, the system is modified and adjusted till the conflict is removed, or at any rate till it is reduced within the limits of what is necessary to eliminate the inconsistences and irrationalities to which common ethical judgments are subject.

For the investigation on which we are engaged we need not adopt a definite system of ethics, so long as we can apply that body of judgments which all systems of ethics alike endeavour to explain and assimilate.

The position can be made clearer by a consideration of that ethical system of hedonism or utilitarianism which had so great a vogue among the economists of the 19th century. The hedonism of Bentham was unqualified and uncompromising; to him the *sole* end was pleasure. "Quantity of pleasure being equal," he said, "push-pin is as good as poetry." But just because this did not conform to common ethical judgments, some of Bentham's successors shrank from his bold doctrine. John Stuart Mill introduced into it a distinction among pleasures, not merely according to quantity, but according to quality. He thought that one pleasure, without being greater, could be *higher* than another. This concession really destroys hedonism. For it means that the sole end is not pleasure in itself, but pleasure in combination with that quality which makes one pleasure higher than another.[1]

Bentham's doctrine indeed seems a monstrous paradox, and Mill's amendment of it no more than a necessary conformity to obvious common sense. It may be admitted, in defence of Bentham, that it is often possible to show that a pleasure which is reputed "higher" is, if its consequences are taken into account, really greater. That is to say, sometimes when we find the lesser pleasure higher, we are really judging it not solely by itself but by its consequences—it will be more lasting, or will bring other pleasures in its train, or will involve fewer countervailing pains.

But even if these explanations are true, they are designed, like Mill's reservation, to bring the conclusions of hedonism into conformity with common ethical judgments—they admit that poetry is better than push-pin, and try to explain it by saying that, though the quantity of pleasure appears to be equal, it is not really so.

[1] See "Principia Ethica" by G. E. Moore, sec. 47.

Nowadays hedonism has fallen out of fashion. We are more inclined to regard pleasure as a mere accompaniment of the satisfaction of our desires than as an end in itself. If the desires are good, the pleasure is good ; if the desires are bad, the pleasure is bad. Of happiness much the same may be said.

It may be objected that by postulating the existence of "good" and "bad" we are already taking too much for granted. Some systems of philosophy deny the validity of these concepts, or explain them away. One school of thought would say that good and bad in themselves have no meaning ; they only become significant in relation to those *for whom* things are good or bad. One man's good is something essentially incommensurable with another's. At first sight it would seem to follow from this theory that we are disarmed from generalizing about the ends of human action at all ; indeed that we are bound to adopt just that uncritical acceptance of each man's judgment of his own ends that is contained in the economists' doctrine of utility. But that is not necessarily so. For even if each man's good is strictly relative to himself, that does not preclude other people from knowing anything whatever about it. The economic problem, being concerned with the joint action of human beings, must be concerned in some sense with joint ends. If each individual who participates aims only at what is good for himself, that must be because a joint end can be found, which somehow includes the good of himself and that of each of his neighbours. In looking for such ends or criticizing them, we are employing the same sort of common ethical judgment as in the application of any other philosophy. And this applies equally to another philosophy which denies the significance of good and bad altogether, and regards them as abstractions derived from feelings of "approval" and "disapproval," which the course of evolution has planted in our nature in regard to certain classes of objects. For one who studies the economic problem must be presumed to be interested in the ends to be sought and to be attained by people other than himself ; he is so interested because he *has* these feelings of approval and disapproval, whether they are directed towards some real attribute of good or evil in things or not. In so far as other people have similar feelings of approval and disapproval, he and they will find common ground in their search for a solution.

Thus it is possible, in applying ethical criticism to the actual ends of human conduct, to avoid prejudging the great metaphysical issues. On the other hand there remain

the wide differences of opinion among individuals as to ideals and standards. We must not exaggerate the extent of the general agreement to be found in the common ethical judgments of mankind. Everyone must exercise his own judgment, and if in what follows the reader finds much with which he disagrees, I trust he will not think that I wish to dogmatize or to thrust upon him views which do not accord with his own. But I do ask him to agree as to the relevance of such questions to all possible solutions of the economic problem.

CHAPTER XVII

OBJECTS OF CONSUMPTION

TAKING welfare to comprise all those experiences which possess ethical value in themselves, or, that is to say, are *good as ends*, we have to examine the products to which the economic activity of mankind is devoted and to find to what extent they really promote welfare.

We can confine ourselves to *finished* products, or objects of consumption. The value of intermediate products depends upon the value of the finished products for which they are the means.

It will be convenient to distinguish two broad classes of objects of consumption : on the one hand those products which are intended to prevent or remedy pains, injuries or distresses, and on the other those which are intended to supply some positive gratification or satisfaction. They may be conveniently named *defensive* products, and *creative* products. It would not be legitimate to say that defensive products are directed against evil and creative products towards good, for to assume that the troubles counteracted by the former are really bad, and that the satisfactions promoted by the latter are really good, would be to accept the judgment of the individual in regard to the ends of his action as necessarily correct. That is precisely what we have decided not to do. The distinction is based on the nature of the ends actually sought, whether wisely chosen or not.

The two classes of products, defensive and creative, are neither mutually exclusive nor exhaustive. The same product often fulfils purposes of both kinds. Food, for example, is needed to guard against hunger, weakness and ultimately death by starvation, but at the same time different kinds of food are designed to give the consumer positive satisfaction. This duality does not invalidate the distinction.

We may regard either class of product as meeting a *need*. In the case of the defensive product the need arises from the

distress caused or threatened by some physical condition. No imaginative effort from within or prompting from without is required to awaken the need. In the case of the creative product on the other hand, the need can only arise from a knowledge of the possibility of the product. Obviously that knowledge cannot take the form of an original invention of something new, save in rare and exceptional cases. The ordinary man can only gain it from the experience of himself and his neighbours.

Invention and experience are both required, it is true, to discover the best means of meeting needs, even when the needs themselves are self-revealed. We know that we want to avoid hunger and thirst, disease, pain and injury, excessive heat and cold, but we have to learn how to get food and drink, shelter, clothing and fuel. Often the choice of means is a matter of profound science, as in the prevention and cure of disease. Knowledge and experience are required to *foresee* the need. But no constructive effort is involved in the mere feeling of the need itself.

The richer the consumer is, the further will he be able to go in eliminating or mitigating distresses. The first care of the very poor is to guard against the most elementary pains and hardships. Those who are a little more prosperous, besides launching out into expenditure on products of other kinds, can also afford to remedy less pressing pains and discomforts ; they can have comfortable chairs and beds, and an assortment of clothes, adapted to different weathers ; they can escape fatigue by using vehicles ; they can obtain better facilities for keeping themselves, their clothes and their belongings clean. The rich man can afford to be fastidious in avoiding whatever he finds uncomfortable, fatiguing, unhealthy, disgusting or ugly. The greater the variety of evils from which he asks to be protected, the greater are the demands he makes upon human ingenuity to devise remedies or preventives and upon human effort to produce them.

A special class of defensive product is the kind of expenditure which is intended to provide *leisure*. Sometimes this is not expenditure in the ordinary sense, but a limitation of the time given to work and a consequent sacrifice of earnings. But much actual expenditure, especially among the rich, is incurred for the sake of increased leisure. A man can increase his really available leisure by using labour-saving contrivances and by employing servants to do things which he would otherwise have to do for himself ; still more can a married woman increase her leisure by devolving upon

servants the heavy burden of housework which the tradition of the family places upon her, and a part of the work of looking after her children.

Leisure, like money, is a form of power, which people covet without necessarily having any clear idea of what use they wish to make of it. To avoid some encroachment on one's time seems to be clear gain, and therefore a safe object of expenditure in any event.

It is possible for a rich man to incur heavy expenditure without any assignable purpose beyond securing the minimum of discomfort and the maximum of leisure. Those two aims between them will account for a stock of furniture and clothes, a staff of servants, a large house, and many other possessions. But the whole yields no *positive* good; it merely brings him to the zero point, at which he is suffering from no avoidable harm. He has weeded his garden, and still has to choose what he will plant in it, before he can be said to have made anything at all of his life.

But it must not be supposed that the positive good which he is to pursue must necessarily take the form of objects of expenditure, or of marketable products. He *might* find it, for example, in human intercourse and the beauties of nature, without drawing any further on the productive resources of society. Or he might pursue artistic or intellectual activities which make very slight demands upon them It may be indeed that the greatest good, for rich and poor alike, is of this kind. But that does not mean that it cannot at any rate be supplemented by what we have called creative products. And the almost universal opinion of mankind, if we may judge by their practice, is that creative products are a very important good.

Things, like human intercourse or the beauties of nature, which are not themselves bought and sold, may nevertheless only be accessible to the individual through expenditure, for example on travelling. Travelling may be either a defensive or a creative product according to the object for which it is undertaken. In fact travelling in itself is not ordinarily a "finished product" at all. It is part of a productive process, of which the product is the advantage enjoyed by the traveller from his change of place.

An exhaustive classification of creative products is impossible, but it will be worth while to enumerate some of the principal types. To begin with, there are purely sensual pleasures, such as those of eating and drinking. We are stimulated to seek whatever is physiologically necessary for ourselves and our species by instinctive reactions to certain

sensations. Some sensations, such as physical pain, cause us distress, and we are induced thereby to take whatever action we can to end them. Others cause us pleasure, and induce us so to act as to start them, or, if we already have them, to intensify and prolong them. Products of which the purpose is to end the former we have already classed as defensive. Products of which the purpose is to promote physical pleasure are a part of those we have classed as creative. It is not easy to draw the line between products which prevent pain and those which promote physical pleasure, because it is characteristic of any physical need, which causes distress while it is still unsatisfied, to cause positive physical pleasure as soon as it is in course of being satisfied. We have all heard of the man who had a thirst he would not sell for ten dollars The pleasure that arises *merely* from the removal of distress cannot be regarded as constituting the product that occasions it a creative product. But it is often possible by a suitable adaptation or elaboration of the product to procure much more pleasure than the satisfaction of the need alone would yield. Then the product will become creative.

An obvious example is the skilled selection and preparation of food. A man so well fed that he is practically never hungry gets little pleasure from plain and plainly cooked food. But the different kinds of food supplied to man by nature attract him each by its appropriate pleasant flavour or sensation, and it is possible, by a cunning concentration and blending of the elements from which this attraction is derived, as well as by other artifices, to prepare food which is preternaturally pleasant to the eater. This is done partly by cookery, partly by the skilled culture and grading of animal and vegetable products.

There is an incessant conflict between the resources of these arts on the one hand, and the flagging appetites and growing fastidiousness of the overfed epicures whom they set out to please, on the other. Rich foods are usually over-nourishing, and therefore injurious to health, and to appetite. And the habit of good feeding makes people more discriminating and critical of their food, and at the same time less capable of deriving pleasure from it. To those with thoroughly sophisticated palates good cookery has almost ceased to be a creative product. Inferior cookery has become disgusting to them, and they value good cookery chiefly or solely as a safeguard against its atrocities.

A branch of physical pleasures which deserves special mention is that of the drugs taken either in drinking or in

smoking. The pleasure, so seductive to most of mankind, derived from alcoholic drink, tea, tobacco or opium, comes from the physical effects of the drugs uopn the nerves The drugs have their value as defensive products, in that they have medicinal qualities. But they are commonly consumed, when the ills they cure are neither present nor threatening, for the sake of the pleasure they give.

Another class of creative products comprises those that serve the purposes of sport Sport may be defined as physical activity indulged in not for any ulterior purpose, but for the sake of the pleasure it gives. The activity itself is not a marketable product, and for some sports, such as walking or swimming, practically no marketable products of any consequence are required But for most sports some equipment is necessary, and for many the requisite expenditure is heavy Some, such as yachting or horse-racing, are only possible to rich men

The activities of sport are pleasurable, no doubt, on account of an innate propensity to activity planted in human nature. A perfectly rational animal would need no instinctive propensity to activity as such, for it would be active whenever reason showed activity to be desirable. But man is not perfectly rational, and, if he were only active for rational ends definitely foreseen, his activity would be very limited He shares with the non-rational animals a tendency to be active at random, on the chance of something turning up Give him an occupation, and his instinct for activity may be satisfied. But if he has no occupation, or if his occupation is such as to exercise his energy in a one-sided manner, he may derive great pleasure from the activities of sport. Games which exercise only the mind and not the body appeal partly to the same instincts, though some of them, like chess or some card games, give also an intellectual pleasure, which is distinct from the pleasure of activity as such.

In contrast with physical pleasures and pastimes, we find the great and indeed illimitable class of intellectual and artistic products Here we are concerned, it must be remembered, only with *marketable* products, those commodities and services that are paid for.

First we will consider artistic products We must avoid as far as we can the intricacies and puzzles of æsthetics, one of the most difficult and controversial branches of philosophy, and the following remarks on the nature of art will suffice

Artistic products include those of which the aim is *beauty*, whether of vision or of sound, but that is not all. Their function in general is to express emotion, not through the

instinctive signs of emotion, but by communicating the *object* of emotion. The emotion may be the admiration of something beautiful; the artist will then apply his technique to reproducing the beautiful thing. Or the emotion may be directed to some relation among human beings; the artist will reproduce or describe this relation. In this latter case the object of emotion will itself be emotion. It may be recorded in poetry, in narrative, in drama, or in the plastic arts. A picture of a Madonna and Child may be the object, not only of admiration of its beauty, but of an emotional appreciation of maternal love

But the range of Art is not limited to the more exalted emotions. It extends likewise to the humorous. It is not merely that some art is humorous, but that *all* humour is art

Thus the function of Art is to enrich the emotional experience of man If it be true that human feeling is the *only* thing that matters in the world, the importance of art is clear.

Artistic products fall for our present purpose under three principal heads: entertainment, applied art, and pure art.

By entertainment we mean an occupation for people's leisure, which differs from sport in not being their own activity. They are purely receptive. The instinct of activity works in the mind as well as in the body; thought is perpetually moving, but if it is not supplied with sufficient subject matter the instinct of activity ceases to be satisfied, and boredom supervenes Entertainment which *merely* prevents boredom might be classed, like applied art which merely prevents ugliness, as a defensive product. But in this instance it is again true that the purpose of the defensive product cannot be attained except through positive qualities, which constitute it a creative product.

An entertainment which fulfils its purpose of preventing boredom need not necessarily have any artistic merit. All that is strictly necessary is that it should supply a sufficient stock of impressions to fill the mind. But even this is a creative product; the impressions have to be invented or selected, and must be such as to awaken in the mind some interest, however fleeting. And the endeavour to interest, if it is not to fail, is very likely to lead on to the entertainment being given either an artistic form, or alternatively an intellectual interest.

Examples of non-artistic entertainments are to be found in exhibitions of sports, of athletic or acrobatic skill, or of wild animals. Dramatic entertainments however slight their artistic merit are artistic in form, inasmuch as they

are intended to *express* something. The same is true of literary work.

Next we turn to Applied Art. Applied Art is concerned with beauty. Its function is to confer beauty of form and colour upon those products which primarily serve some other purpose. Any material product may, within certain limits, be more or less ugly or beautiful. For those which are consumed almost as soon as produced this aspect counts for little, but for those, such as clothes, furniture, or buildings, which are durable, external appearance is important. In so far as they merely avoid being ugly, they might perhaps be classed as defensive products, but the avoidance of ugliness as a practical aim is inseparable from the attainment in some measure of positive beauty. And in fact it is here that we find the most characteristic demand for creative products. A cultivated taste will shrink from the acquisition and use of ugly things, but only imaginative invention can cure the defect. It may cost little or no additional effort to make an article beautiful instead of ugly. But the faculty of design is rare, and beautiful things usually command a scarcity price. Sometimes the product can only be beautified at the cost of some further effort; it may need special materials, special care in construction or perhaps a more decorative design. In that case the extra cost may be regarded as the price of that element in the product which may be distinguished as creative.

A product of pure art is one in which artistic merit or at any rate artistic purpose predominates over everything else. In form it may be applied art or entertainment, or it may be neither; it is not necessary, or indeed possible, to draw an exact line. But there is evidently a significant difference between him who, in producing things for practical use, endeavours to conform to good standards of taste, and him whose aim is to create the most beautiful things he is capable of designing, and who chooses practical objects as the vehicle of his art. The difference is still valid, even though the failures of the latter may be artistically inferior to the successes of the former. The same difference exists between the purveyor of entertainments, who aims at producing what is artistically good, and the artist who makes use of the entertainment form as a suitable setting for his art.

Finally we turn to *intellectual* products. There are limits to the ways in which thought can be made a marketable product. Rights of property can be created by law in inventions which are technically useful, through the rather cumbrous device of patenting; the inventor is given for

a period a legal monopoly in the use of the invention, so that everyone who uses it can be made to pay him something for the privilege. Original thought or research is sometimes subsidized by the State, or by private patrons, or endowed. But it is far more usual for the intellectual worker to get remuneration for his services through the *communication* of his ideas. Intellectual training forms a large part of education, and one class of intellectual worker supplies this service. Others write in books or newspapers, their property in what they write being secured by the law of copyright.

Thought may be valued either because it is useful or because in itself it gives intellectual pleasure. In so far as it is useful exclusively for some economic purpose, such as production, business organization, or finance, it is used and paid for not by consumers but by traders, and it does not rank as a final product. But it may be useful for other purposes, for example, books, pamphlets and newspapers may be used to disseminate and advocate ideas with a view to political action or to the spread of religion or to social progress.

Thought which is useful may also give intellectual pleasure. But there are wide fields of intellectual activity where the primary object is intellectual pleasure, and practical usefulness, if it arises at all, is only a by-product. Examples are philosophy, pure science, history. Works primarily of *literary* value are to be classed as artistic rather than intellectual products.

It is hardly necessary to repeat that the foregoing brief survey of possible objects of consumption is not intended to be exhaustive. But it will serve our purpose if it has covered enough ground to make a criticism of wealth, regarded as an end, intelligible.

We have now to attempt an assessment of the ethica value of these categories of wealth. Defensive products, as we saw, are intended to eliminate distress. How far is distress really bad ? Perhaps the prevention of starvation and disease is the most unequivocal benefit that economic action can bestow. But that is partly because a certain minimum of physical well-being is necessary as a *means* of all other ends. Pain is a symptom, a warning of physical disorder, which, if not remedied, may threaten disablement or death. Pain is also a distraction ; if of a certain intensity, it prevents or impairs activities of every kind.

Most people would be prepared to add that pain is bad in itself, that, apart from any harmful consequences, it is

the most obvious example of intrinsic evil. The question is not quite so simple as it seems. In the first place, what is bad seems to be not the specific physical sensation of pain, but the distress that it causes. It is possible that this distress has come to be associated with it through the working of natural selection, and that the connexion between the two is not essential but derivative or *contingent*. We are perpetually suffering slight pains which cause us no distress, and which for that reason we do not count as evils. And when, by suggestion or similar means, the attention is so diverted from serious physical pain that there is no distress, most people would say that the evil of the pain is removed with the distress.

And is even distress bad *in itself*? Distress is a state of desiring to escape from conditions that are being experienced. The distress caused by pain is an entirely unreasoning desire to escape from the pain. It is arguable that it is bad only in its consequences, not in itself, that it is bad only because it excludes from the mind all activities other than the striving to get rid of the pain.

As to this question we need not come to any decision. In any case the prevention or cure of physical pain or distress which is serious enough to interfere with the attainment of positive ends must rank as an imperative aim of economic action.

And physical pain or distress which is not serious enough thus to interfere is a relatively insignificant matter.[1] Now many defensive products are designed to prevent, not the primary distresses which are clearly harmful, but minor pains and discomforts. These easily escape attention, and the attention, even if it has been directed towards them, is easily diverted elsewhere But the effort to prevent or cure them tends to attract attention to them, so that the mere use of the product which has this effect often creates the need that it fulfils. A man may live contented with coarse food, rough clothes, uncomfortable furniture, and be hardly aware of the discomforts involved. But when he has experienced choice foods, well-made clothes and comfortable furniture, he will be disturbed by any falling off from the standard he is accustomed to.

It seems at first sight natural to argue that defensive

[1] This must not be taken to mean that the pain which the sufferer successfully hides from his neighbours, and which does not prevent him from pursuing his usual occupations is to be classed as insignificant. If the pain is severe, it will, despite appearances, occupy his attention to the exclusion of other things, and perhaps all the more so because of his efforts of will.

products which merely make people more fastidious and less easily satisfied are a pure waste. That is so in some cases, but not in all. For indifference to certain kinds of evils seems to be bad in itself This applies particularly to what is *disgusting*. About dirt, bad smells, gross habits, people *ought* to be fastidious.

In every civilized community an enormous amount of labour, paid and unpaid, is devoted to cleaning. This is partly justified on the ground that dirt is injurious to health. But it is far from being limited to what is really necessary for this purpose. One of the signs of culture and of social standing is fastidiousness about dirt. It is a privilege of the rich man to have an indefinite number of clean shirts, and to be spared the distress of seeing a film of dust on his furniture. The poor man cannot hope to reach so high a standard as the rich, and can only keep his person and his belongings in a presentable condition of cleanliness at the cost of a severe burden of work, which probably devolves upon his wife. This burden means both fatigue and a curtailment of leisure, and is a heavy price to pay. But there would be fairly general agreement that the end is worth a considerable sacrifice, and that indifference to dirt is a real evil, even though the fastidiousness of the rich may sometimes exceed what is reasonable

Turning next to the creative products, we come first to those giving sensual pleasure. As has already been pointed out, these are not far removed from defensive products Food taken merely to satisfy hunger is a defensive product. The fastidiousness which the art of cookery in its higher flights serves is ethically not very different from the fastidiousness in respect of comfort to which we have already referred

The needs arising out of fastidiousness of either kind do not deserve to be rated very high in the ethical scale. In one way, however, they have reactions which are of some importance. We have already mentioned human intercourse as a kind of good which is not in itself an object of expenditure Incidental to human intercourse is the need of some means by which one man can easily show his goodwill to another. This can be done by offering something that the recipient may be presumed to like. For this purpose food and drink are particularly suitable because the needs they satisfy are continual and universal Other creative products a man hesitates to offer to one whose tastes he does not know. The difficulty of choosing presents, even for a friend of known tastes, is familiar to everyone It is especially great in the case of *durable* commodities, which only need replace-

ment at long intervals, and of which the friend may already possess an ample supply. Food and drink, therefore, play a part, along with entertainment and other amenities, in the practice of hospitality. They gain thereby a symbolical significance, which justifies a fastidiousness and consequent care and expense which would not otherwise be reasonable. But in this respect they are valued not as ends in themselves but as means to social companionship.

Is there then nothing to be said for the epicure? He has faculties which are lacking or at any rate are undeveloped in the great majority of his fellows. He has the discrimination to appreciate good wine or good cheese, choice fruits or delicate vegetables, and flesh, fish or fowl, exquisitely selected, cooked and served. In him the cook finds his kindred spirit, one to whom he can express himself in the sure confidence that he will be understood. The bad effects of too much eating and drinking are not relevant to an estimation of their value as ends in themselves. But it must be admitted that the prevalent verdict would be that the refinements of eating and drinking, especially if separated from conviviality, are not very worthy aims of human endeavour.

If we turn next to sport, we find something which prejudice is disposed to favour, because it has good effects. Most forms of sport are healthy, and many forms have a beneficial influence on the faculties, both physical and mental Sport therefore compares favourably with entertainment; for whereas both pass the time pleasantly and prevent boredom, the passive spectator of an entertainment gets nothing else out of it.

If we reduce entertainment to its most elementary terms, abstracting it from all artistic or intellectual merit, divesting it of beauty, humour, or emotional interest, it is left a purely defensive product; a remedy for boredom. Its value then depends on how great an evil boredom is. But, be its value great or small, it resembles other defensive products in that it can only help to bring life to the zero point at which distress has been eliminated. Leisure, the time saved from productive occupations, ought to be the opportunity of making something of life To create leisure and then to occupy it by killing time is a contemptible confession of failure. It may be well to repeat that the activities or interests by which leisure is to be occupied, or rather to be used, are not necessarily objects of expenditure; they are not necessarily products of the economic organization of society Such products are only called in aid when these other

activities or interests either need supplementing or fail altogether

Entertainment as a purely defensive product is little more than an abstraction. Amost invariably entertainment that is to attain its purpose must have some artistic flavour; if not beautiful, it must be either emotionally interesting or at any rate humorous. And it is these qualities that make it a worthy use for leisure. That does not mean that it need necessarily have any considerable artistic *merit*. When we speak of artistic merit, we usually have in mind the standards of pure art, in which merit implies something of originality, imagination or inspiration. That is because those who speak of artistic merit are, or aspire to be, connoisseurs, not too easily satisfied. The original artist is rare. And though his own work is actually dealt in in the market, its chief importance among marketable products is as leaven which leavens the lump. A society which, in new artistic work, is absolutely sterile, might nevertheless enjoy products of high artistic merit handed down from a past age. Its deficencies would be none the less real for not being reflected in its marketable products, for the activity of the artist communicating his living spirit to his neighbours is a good of the highest order.

Entertainment, like most other things in human life, has its relation to social intercourse and companionship. Social intercourse needs something to feed on. Sexual instinct and the complicated reactions arising out of it sometimes supply all that is required. But otherwise in general, people without exceptional gifts of originality, who meet together, unless they are interested in something outside themselves, will soon become bored. Entertainment is one among many ways of meeting this need. People can enjoy it together, or can exchange ideas about it, and the better the entertainment in itself the better the material for converse that it affords.

Applied art has much the same relation as entertainment to pure art. But in other respects its relation to life is very different. People can dispense with entertainment if they have sufficient interest in life without it, or if entertainment has nothing to offer them. But the material objects which they use must have *some* external appearance; they may be either beautiful or ugly, and from that there is no escape. To be beautiful, they need not be made from an original design. Provided beautiful designs are to be found, things can be made in conformity with them, if only the consumer and the producer between them can muster sufficient discrimination to choose wisely. This is a matter in which

fastidiousness is itself desirable. People ought to prefer to be surrounded by beautiful things. They ought to shun what is ugly in the same way as they shun what is disgusting

On the other hand, when we come to decoration, we are approaching the realm of pure art. Decoration is something *added* to an object, which could fulfil its principal purpose without it. It is added in order to beautify the object Its value (ethically speaking) depends upon its success in accomplishing this aim If it fails absolutely to beautify, the effort expended upon it is wasted ; if the result is positively ugly, the effort is not merely wasted but is actually harmful

The importance of applied art depends upon the extent to which the object in which it is displayed is to be seen by people. The exterior appearance of buildings in a great city should be a matter of great concern to the inhabitants. Clothes worn in public matter more than those worn in seclusion. Ugly advertisements are a serious evil, in that it is part of their purpose to be seen by many people and to attract their attention.

An intellectual product, as we have seen, may be valued either as a means or as an end, and very often is valued as both means and end What is valued as an end is intellectual pleasure, a specific emotion derived from an intellectual study which is *interesting* Most people would place intellectual pleasure high in the ethical scale, but the faculty of enjoying it in any great degree, dissociated from intellectual activities which are also valued as means, is rare. It can never count for much in comparison with the universal appeal of art.

Intellectual activities, viewed as means, are the very basis of civilization. The whole organization of society, economic, political and social, depends upon its accumulated wisdom. In this we are no more concerned with the grading or assessing of human emotions. The question is whether the wisdom is true and is adapted to its purposes.

CHAPTER XVIII

THE CONSUMER'S CHOICE

NOW that we have surveyed and appraised in broad outline the principal categories of marketable products, we have prepared the way for a consideration of the manner and the degree in which the economic system as we know it, attains in these products its end, ethical value or welfare We are debarred from using the "measuring rod of money," for it does not pretend to measure ethical value. Nevertheless we need not be altogether at a loss, for the judgments that we shall be called upon to exercise will be of the same kind as many of the judgments which we are accustomed to act upon in practical life

The consumer who sets out to spend is free to choose any selection of products that the markets within his reach offer. But that does not mean that he either will or can consider all possible selections or even any great variety of them. The greater part of his expenditure is directed to meeting continuing needs for food, clothing, shelter, heating, lighting and cleaning. The methods of meeting these needs are dictated by custom and tradition.

He is free, if he chooses, to depart from custom and tradition. But this freedom is, in the great majority of cases, without practical effect. In the first place, in order to choose a new object of expenditure it is first necessary to think of it To do so unaided would be possible only to a man of originality. Apart from such exceptions, the consumer can only seek to buy things like those that he sees his neighbours use, or things that are actually offered for sale. Of the things offered for sale, he can only become acquainted with an insignificant fraction. A great part of the task of organizing a market consists in the communication to the consumer of information as to the things to be procured from it. If the retailer waited for the consumer to ask, he would sell nothing but what the consumer thought

or asking for. Therefore he puts a selection of things in his shop-window for the passers-by to see. Advertisement is, as it were, an extension of the shop-window. Ostensibly the purpose of an advertisement is to induce people to buy the advertiser's own products in preference to similar things produced by his competitors. But in reality it often has the effect of bringing to the consumer's notice products of the very existence of which he would otherwise have remained ignorant.

His household expenditure is a matter of routine He can only be led to vary it to the extent that alternatives are suggested to him, and alternatives will rarely be suggested to him in any other way than either by advertisement (including shop-windows) or by variations in his neighbours' objects of expenditure. His neighbours are subject to the same limitations as he. Consequently in the last resort changes have to be effected by means of advertisement.

It would be going too far to suggest that consumers remain wholly passive Most people dislike monotony, and are disposed to make some effort to discover new objects of expenditure, new items of diet, new patterns of clothes, new kinds of ornaments, new amusements But their choice is as a rule absolutely limited to the things on sale, and among the things on sale, to those of which they can obtain information through the market Such information is most easily obtained from advertisements spontaneously offered by the market, but the would-be purchaser will often himself make inquiries from the dealers in the market. The dealers whom he approaches with his inquiries are the shopkeepers But *their* knowledge is limited The highly skilled shop assistant knows much of the commodities he deals in, their uses, their qualities, their suitability for particular conditions. But those less skilled depend very much on the information derived from the advertisements of producers and wholesale dealers. The shopkeeper's task is enormously facilitated if he can offer his customer an article authenticated as the product of a manufacturer known by name to both of them. Self-praise, it is true, is no recommendation, but an undeserved reputation acquired by a producer through advertisement is precarious Not only do the more discriminating consumers refuse to purchase the product twice, but the shopkeeper, when he finds his customers complain, will eventually cease to recommend it

Thus advertisements of commodities are addressed quite as much to the shopkeepers as to the consumers And this goes far to explain the great importance which advertising has

acquired since the means of disseminating information have been so developed as to make it possible on the grand scale

Thus the consumer who seeks a new outlet for his expenditure, is likely enough to have to find it through advertisement. His choice of products is doubly limited It is limited to the things actually produced and put on sale, and among those things it is limited to the things brought to his notice by advertisement or otherwise.

But that is not all. For against the consumer's dislike of monotony and his desire for novelty to escape from it, must be set the tremendous inertia of custom

In Chapter XIV, in connexion with the family and the upbringing of children, we had something to say as to the *rationality* of conservatism. We do what our neighbours do, not from some innate disposition of imitativeness, but because their doing it creates a presumption that it is a desirable thing to do. Each consumer is content to meet his needs in the same manner as the others meet theirs. To try a new way is to make a venture into the unknown on the faith of an unverified expectation. The venture may encounter unforeseen evils, and the mere fact that other people do not undertake it suggests that there is some objection to it.

This is true in some degree even of defensive products. Where the need to be met is palpable, people are nevertheless slow to meet it or to improve upon the imperfections of existing methods of meeting it. The existing methods have at any rate been tested, and their imperfections are known. Even very obvious improvements often require a good deal of pushing, and the difficulty of getting them accepted by consumers is reflected in the reluctance of traders to adopt them. After the tremendous flood of inventions with which the last few generations of men have been familiar, it has become far easier than it used to be, at any rate in Europe and countries inhabitated by Europeans, to induce changes in the material methods of meeting needs. The obstruction to improvements, both in defensive products, and in labour-saving contrivances and means of transport, has been largely removed

On the other hand in the realm of creative products the power of inertia remains as great as ever. So long as a man's possessions are in the same style as those of his neighbours, he escapes criticism. The moment he departs from the dictates of custom, he is saddled with responsibility for the choice. Should he be entirely confident in his own taste, he will perhaps be prepared to brave the consequences. But most

people, whatever they may pretend, are far from trusting their own taste Probably they have never thought of the possibility of procuring anything outside the conventional styles and patterns, and, if an article differing too conspicuously from those possessed by their neighbours were offered, they would shrink from it in terror.

One of the chief aims of advertising is to produce the impression that the thing advertised is of a kind that everybody buys. That is an appeal to rational imitativeness. The impression is created not merely by direct statements to the effect that great quantities are being sold, but by pictures and written words calculated to produce in the mind the same sort of familiarity as if the article advertised were in fact being extensively used From that familiarity, the biased source of which is easily forgotten or overlooked, proceeds the confidence which induces people to buy.

The development of large-scale production has brought with it a huge extension of advertising. No producer is satisfied with a restricted market. Advertisement enables him to extend his market, and so he advertises.

Advertisement affects the consumers' inertia in two opposite ways On the one hand it enables the trader who brings some new product to market to get it accepted more widely and more rapidly. But on the other hand every article that has been extensively advertised becomes firmly established; it acquires a "goodwill" of its own to the exclusion of other things, and the traders interested in it will resist innovations. Even quite slight changes of pattern may sacrifice part of this goodwill.

On the whole large-scale production reinforces the consumers' inertia. It stereotypes patterns, and makes any departure from accepted styles more exceptional and therefore more eccentric.

It is particularly in the expenditure of the rich that imitativeness has the most pronounced effect. There is more variety in the expenditure of the rich than in that of the poor, but that is because there is greater room for variety. A man with a very small income has to content himself with few and modest creative products. Far the greatest part of his expenditure is devoted to meeting the most obvious physical needs. What he is left free to spend is little, and he is reluctant to spend any of this precious surplus except on things which he is quite certain he wants.

The rich man's free margin, because it is large, presents a more formidable problem. It makes correspondingly greater demands upon his power of choice. The number and

variety of the alternatives that he must think of is proportionate to the amount of spending power to be used up.

Faced with the problem of how to spend his income, he finds that his predecessors have been engaged upon the problem for centuries, and that they have built up a tradition showing him and his contemporaries exactly how to spend any income however large.

The foundation of the scheme is a panoply of defensive products. It is taken for granted that anyone who has the means will wish to be saved from all discomfort, squalor, and trouble. The first charge on a rich man's income is an establishment planned for this purpose. A large house will contain different rooms suited for different purposes, each equipped with appropriate furniture. He and the members of his family can be isolated from one another if they wish, or can meet together without getting in one another's way. There will be space for the entertainment of a crowd of friends and acquaintances.

He will employ servants to cook and serve food for himself, his family, and their guests, and to save them all avoidable drudgery. Servants also will be needed to keep the house and furniture clean. The house must contain accommodation for these servants, and they make work for one another Their rooms have to be swept and cleaned, their clothes kept in repair, their slops emptied, their food cooked. The services that the employer derives from a staff of servants are only the surplus left after they have performed the necessary services for themselves and one another A tremendous domestic machine is needed to produce very moderate benefits for its possessor.

The rich man need not be content with a single establishment. To a large house in the principal city of the country in which he lives he will add perhaps a country house, or even several, with furniture, and gardens and with a staff of servants and gardeners. He may have one or more houses in foreign countries chosen to provide him with a change of climate and scene at seasons when his own country is too hot or too cold or wet or unhealthy

He can himself only use one of these houses at a time, and, though sometimes they may be used to accommodate friends or members of his family, the waste arising from their being often left empty is a characteristic consequence of the system.

His private vehicles will afford him the means of locomotion, and, when he has occasion to travel for long distances, he will find that the railways, hotels and shipping companies

all over the world offer him special comforts and facilities at high prices.

Long tradition has elaborated the art of spending on clothes. The rich man must discard clothes which show any signs of wear. He can change his linen as often as he pleases He will have his clothes made by someone with exceptional skill in cutting them to fit. His wife and daughters will be clothed in garments requiring the maximum of labour and skill in production, and will discard them in favour of new creations without even awaiting a change of fashion.

Here we approach the realm of creative products. It may be safe to assume that all rich men who are not eccentric will wish to escape trouble and discomfort, and to increase their leisure. It is quite a different thing to attribute to them discernment in matters of taste. Fashion is a substitute for taste. The qualities in things that make them fashionable, are of the same kind as those that make them beautiful or ugly. But it is much easier to tell whether an object is fashionable than whether it is beautiful or ugly. The latter judgment involves a perception of its merits and requires a cultivated taste, whereas the former requires no more than a perception of the object's resemblance to other objects

A very large part of the rich man's expenditure is upon things which are intended to be decorative. His possessions will include objects of applied art in which in many cases the decorative purpose will count for much more than that of utility. They will also include many things of which the purpose is purely decorative The rules of fashion will help him to choose these things, his clothes, furniture, ornaments, the scheme of decoration for the rooms of his house

What convention particularly requires of all these is that they should have some costly qualities. Artistic beauty, in so far as it is appreciated or enters into the fashionable styles, may be one of these. But magnificence, which may be utterly ugly, or mere elaboration, involving a great expenditure of labour or the use of rare and precious materials, may equally well serve to symbolize wealth So long as he conforms to fashion, he is proof against criticism on the score of style

To occupy his leisure, the traditional scheme of expenditure offers him, besides expensive sports and entertainments, so far as he cares for them, social intercourse. He is expected to afford hospitality to his friends in proportion to his means That is one of the main objects of his big house and his servants The forms that his hospitality should take are prescribed by the customs and conventions of the society

in which he lives So long as he confines himself to these, no special capacity or originality is demanded of him.

The outstanding characteristic of the system is that the rich man is at every point relieved of any strain upon his capacity. He is not required to originate anything ; he is not required to exercise any judgment, discrimination or taste. All he has to do is to apprehend and follow the precepts of convention. At its worst the expenditure of the wealthy under these conditions might be unmitigated waste. In practice, however, things are not as bad as that.

In the first place the fashions of the day are rarely composed of unrelieved ugliness. On the contrary there have been periods when society seems to have been permeated with a love and appreciation of the beautiful. To us there appears to have been a touch of magic about Periclean Athens or Mediæval Italy. Standards of beauty which are exceptional to us were to them normal. All the products of applied art, buildings, furniture, utensils, clothes, jewels, were beautiful, and it was a matter of course for the ordinary rich man to spend his money on such things.

Probably such a golden age seems rather more golden in retrospect than it really was. The ugly things have for the most part vanished, and even those that have survived assume a glamour from their relation to the styles of the period.

But whatever allowances have to be made, we may be quite sure that there would have been no need to deplore the imposition of the fashionable standards of those times upon the possessions of the rich men.

At times, however, fashionable standards are desperately low. Perhaps the lowest standards of which we have any reliable record were those of about the third quarter of the 19th century, when the deadening and vulgarizing effects of the industrial revolution had reached a climax. But every such lapse contains within itself the potentiality of reaction. A sense of beauty is characteristic of normal human nature, though it differs from some of our faculties in that it usually requires a certain amount of training and tending before it becomes effective.

Even in a period of the greatest degradation of taste individuals will always be found who will not acquiesce in the prevailing ugliness. At what may be regarded as an average period, the conventionalized objects of expenditure will be of mixed and uncertain merit. Viewed from the artistic standpoint they will give little return for the vast amount of effort spent upon them.

Art, however, is not the whole of life, and, as we saw, social intercourse plays a great part in the expenditure of the rich. Social intercourse may be facilitated by the amenities, the conveniences, and the material advantages which a rich man can supply. But at best these are little more than the frame of the picture. The picture itself is composed of the disposition and talents of the man and his friends. These will not necessarily be any better than among a party of workmen in a public-house or a party of tramps by the roadside.

The rich man and his friends have some advantages. Social intercourse cannot flourish in a vacuum. It depends upon the ideas of those who take part in it. People who have received an expensive education, have had varied experiences, and have been familiar with beautiful and interesting things, have to that extent a more bountiful stock of raw material. The rich host also can supply his guests with luxurious food and drink, and comfortable surroundings, and can stave off boredom, when it threatens, with a variety of sports, games and entertainments.

But these and a hundred other material advantages are no substitute for the genius of companionship. Companionship may be starved and degraded by the miseries of poverty, but it cannot be bought with wealth. As with the defensive products, wealth can do no more than bring its possessor to the zero point. This, no doubt, is something to be grateful for. But wealth does not even ensure the zero point. Social intercourse may be so overgrown with the appurtenances of wealth that it is stifled. People may be too much absorbed in the products supplied for their use to attend to one another.

The rich man *may* rise above the conventional standards. He may have good taste, social talents and intellectual attainments. If so, his wealth will bring him some opportunities that he values. He can acquire beautiful objects, he can offer pleasant surroundings to his friends, he can equip himself with books and all the material means of intellectual study. But except in collecting beautiful objects, wealth really adds very little to what he can do in these directions. And in so far as he appropriates beautiful things, he withholds them from the enjoyment of anyone except himself and his friends.

There is a desire for possession, which resembles the desire for money in being a particular instance of the love of power, but it is one degree more specialized. Anyone who sees a desirable object may feel moved to acquire it for his

own, not because he will certainly wish to use it or to enjoy it, but because the best way to ensure its being available in case he *does* so wish, is to possess it. He will buy a microscope in case he should want to examine specimens, a billiard table with its equipment in case he or his friends should want to play, a portfolio of engravings in case he should want to look at them. A rich man whose immediate wants are amply satisfied is apt to accumulate ever larger and larger reserves of objects which he requires only contingently and remotely.

He is in the position of dictating to producers to use their best efforts and skill in providing beautiful objects or exquisitely adjusted apparatus, and then of withholding these products from any but the most limited and inadequate use. This is perhaps better than insisting on the production of essentially useless and ugly things, because there is some virtue in the productive activity itself. Still it is organized waste.

He may acquire merit as a patron of art, looking beyond the product to the individual who produces. In an individualist society the artist is dependent upon his market. An organized market is likely to be very insensitive to the qualities of imagination which distinguish the true artist If he is more than a highly skilled tradesman supplying decorative goods according to pattern, he must contribute something which is really his own or which is outside fashion. The market will be shy to take such things, and, unless someone can be found to give a lead, the artist will be left destitute. This is the opportunity of the patron. To be able to seize it, he must be a man of discriminating and cultivated taste, and he must have the courage of his convictions. The system is a bad one, placing the artist in an undesirable position of dependence upon the patron, but it is defensible as permitting the establishment of a few oases in the desert of commercialism.

The patron can buy the artist's works, and so afford him a subsistence, and he can bring them to the notice of other people, till at last the artist will be properly launched, his name will be known, fashion will smile upon him, and he will be free. Lucky if this happens in his lifetime!

To the rich man the customary system of expenditure, unaided by any special discrimination or originality on his part, will only give objects conforming to the standards of culture prevailing around him. The essential function of the system is to offer objects of expenditure to the average rich man It has been evolved by the experience of generations

of average rich men, and anything above their standards does not belong to it.

Conformity to the system is the recognized outward symbol of wealth. Wealth outwardly recognized is one of the principal objects of human ambition. The desire for recognition as a rich man is therefore a powerful motive of conformity. He who is rich is expected to adopt the standards of comfort, of fastidiousness, of lavishness, of hospitality, appropriate to his wealth. If he fails to do so, he will not gain the full status that he might assume

Conformity requires a degree of culture not *less* than the average, as well as one not more. Social grading depends not merely on the possession of wealth, but on the use of it in the prescribed manner, and this requires to be learnt.

We have been speaking of the expenditure of the very rich. But each income level has its appropriate standards. The pressure of opinion has for each social grade an equalizing effect, not unlike the equalizing effect of a market upon prices. The social grade evolves, as it were, a typical or standard man, who combines with the appropriate income sufficient discrimination to spend it in the approved manner. He who achieves the income and does not know how to spend it properly, is despised as a vulgar fool for his wasted pains.

The standards of culture socially recognized vary widely in different places and at different periods. Industrialism has gravely lowered them, and despite a very welcome reaction in the past generation, they still remain low. On the other side intellectual progress has been great, but when we are considering objects of expenditure no amount of intellectual progress can make up for the degradation of taste. Intellectual activity, though of deep import in life as a whole, takes a relatively modest place among marketable products,

Thus on the whole the conventional standards of expenditure have become extremely unsatisfactory. People are to be found in every rank of life who are dissatisfied with them. But revolt is beset with dangers and difficulties The majority take the line of least resistance, and in the expenditure of their incomes deviate little from the customary plan. Only a man of some originality and imagination can go beyond passive dissatisfaction, and even be aware that there is anything to rebel against.

Even passive dissatisfaction has its effect. Those who have no positive ideas of the objects of expenditure which they would desire, but nevertheless find the conventional

manner of using up an income empty and tiresome, may prefer to accumulate most of it unspent. We have already shown how the desire for money for its own sake results from the absence of any clearly defined desire for the objects of expenditure. This desire for money is not peculiar to rich men, but it is only they that are put in the absurd position of increasing their fortunes in geometrical progression, merely because they do not know how to spend what they already have.

In the middle grades of society the conventional objects of expenditure are less futile. Even though it would in reality be possible to make a far better use of a given income, still the typical possessor finds some appreciable advantage in most of the products which he is led to buy. The relation between income and standard of living is closer than among the very rich, because within the range of moderate incomes the additional products procurable with each extension of income are not like the superfluities of the rich, but are usually of a kind that the possessor may be supposed really to care to have. If he does not possess them, the most probable reason is that he cannot afford them.

To any given income there corresponds an appropriate degree of fastidiousness. A man's social standing depends on the degree of fastidiousness he displays. It appears in almost everything he does, in the food he eats, the clothes he wears, the house he lives in, his personal habits, the sports and entertainments in which he indulges. These things all go to show just what a shilling is worth to the man. It is an object of social ambition not to appear to care too much for the marginal shilling. Therefore the socially ambitious man is impelled to make a parade of fastidiousness. He is ashamed to be seen forgoing any of the refinements which a man of his standing is expected to be accustomed to.

A given income presents the alternatives on the one hand, of social standing, which involves expenditure up to the requisite standard, and on the other, of accumulation. The choice is very much a matter of temperament. Accumulation is not necessarily in all cases the more prudent. It promises greater resources in later life, but they may only come too late, when it is no longer possible to acquire the tastes and habits appropriate to them.

Even to the sons and daughters the greater eventual resources may not be compensation for a want of social training, which disqualifies them as much as their parents for the social grade to which they aspire. It is in the middle

class that the conflict of motives is most acute. In that class social distinctions are most real—the standard of refinement is most easily measured. At the same time it is on the whole in the middle class that most weight is given to considerations of providence.

Civilization brings with it a great variety of tasks which demand a certain intellectual equipment and power of taking responsibility. The people fitted by natural gifts and by training for such tasks are able to claim from the labour market a higher rate of remuneration than the ordinary workman. A certain degree of culture is essential to these activities, and therefore it is one of the characteristics of the middle class to care about education. The kind of education that they favour is not necessarily ideal, but if it is to fit them for their place in the market it must develop their faculties in certain ways. An incidental result is that they are better qualified as consumers. They are on the whole wiser in spending than the rich, whose material fortunes do not depend upon their training and accomplishments. The rich are being always recruited from among the successful middle class, but the families that become rich are apt to lose their middle-class characteristics in a few generations.

The middle class is perhaps best distinguished from the lower by this educational test. It may be that a greater enthusiasm for education is to be found among some of the poorest people, and even that, with the facilities that modern public policy places within their reach, they attain in some cases a level of culture above that which satisfies the middle class. But there remains the difference that to those of the middle class, education is necessary to their vocation.

When we turn to the standard of expenditure of the lower or poorer class, we find that they, even more than the middle class, limit their expenditure to products of which they really feel the need. But that does not mean that their needs are wisely regulated, or are met, even approximately, in order of urgency.

For the poor man defensive products assume a special importance. He does not seriously miss the refinements by which the rich man seeks to eliminate minor troubles and discomforts from his life. Indeed the rich man, by becoming more fastidious and sensitive, to a great extent defeats his own object. Within limits the poor man gets accustomed to the hardships he has to face and does not mind them. So long as these hardships are not actually injurious in their ulterior consequences, he is no further

below the zero point than the rich man, for all the care and expenditure of the latter.

Nevertheless there is a degree of poverty at which this condition is no longer fulfilled. Privations bring under-nourishment and ill-health, and threaten the powers alike of enjoyment and of activity. The most obvious problem of poverty is to assure an adequate supply of defensive products to prevent this stage being reached. There can, of course, be no radical cure except by increasing the resources of the poor.

When resources are inadequate, the wise application of them to meet the most urgent needs requires a certain amount of knowledge. Probably with the growth of industrialism and the infinite specialization of sophisticated town dwellers, this knowledge, far from improving, has actually deteriorated, through the loss of the traditional beliefs and customs handed down in simpler and more primitive communities. Poor people in modern towns, unable to have all the food they would like, do not know by what selection to make the best of it. They do not know whether warm clothes in winter are more important to health than excursions into the country on the occasions of their rare and precious holidays. How much work and expenditure are they to incur, at the cost of neglecting other urgent needs, upon keeping themselves and their houses clean? These are problems that would puzzle well-to-do people as much, if they had to face them.

Human nature can rise superior to privations. It is *possible* for life to attain the greatest spiritual heights in spite of them. But that cannot be anything but a rare exception. More especially is the struggle hard when the same poverty which cuts short the means of physical welfare denies access to any but the most wretched and degraded creative products. The poverty of a rough and simple peasant life is usually a smaller evil than slum poverty, because the peasant life proceeds amid tolerable or possibly beautiful surroundings, whereas the environment of the slum dweller is altogether repulsive. Add the lack of culture and the lack of leisure, and poverty is adequately equipped to stifle the noblest soul.

The same power of habit which enables a man to disregard physical discomfort unfortunately deadens his discrimination in things where loss of sensitiveness is a fault. It makes him indifferent to dirt and to disgusting surroundings, it makes him blind to beauty. Poverty works in a vicious circle. Because people are poor and cannot afford to acquire

beautiful things, their appreciation is stunted. And because their appreciation is stunted the trader has no motive to supply them with beautiful things. The evil is aggravated because the conditions of large-scale production do not admit of the idiosyncrasies of exceptional consumers being suited except at a high cost. Production is designed to suit the average, and the conditions of poverty keep the average low.

We reach the conclusion (to which the reader would very likely have been willing to agree without all this detailed argument) that the consumer's preferences have a very slight relation to the real good of the things he chooses. Market value is so far from being a true measure of ethical value that it is hardly even a first approximation to it.

We are compelled, therefore, to give up what has been from the very start the leading idea of economics, the idea of a *measurable aggregate* of economic welfare, which forms a part or a constituent of welfare as a whole. The mercantilists' ideal of wealth, the classical economists' ideal of utility, Professor Pigou's "satisfaction," none of these can be legitimately so regarded.

It is not merely that when the aggregate of satisfactions is increased, counteracting decreases may be caused in other forms of welfare. That is a matter which Professor Pigou has dealt with quite adequately. If the aggregate of satisfaction *is* an aggregate of welfare, there is a presumption that any change in it represents a corresponding change in the more comprehensive aggregate of welfare as a whole. The presumption may be upset, but, unless it is, it holds.

Our objection goes much deeper than that. The aggregate of satisfactions is not an aggregate of welfare at all. It includes good satisfactions which are welfare, and bad satisfactions which are the reverse.

Further, even if the philosophic position of utilitarianism were accepted, and welfare were identified with satisfaction, such is man's incompetence in seeking his own satisfaction that market value cannot supply a measuring rod of welfare.

CHAPTER XIX

THE DISTRIBUTION OF INCOMES

THE defects of the market as a test of value taken in the fundamental ethical sense arise partly from the imperfection of human judgment in selecting objects of consumption, and partly from the inequality of incomes. On both grounds the individualist system is open to criticism.

According to that system everyone ought to receive the fruits of his own efforts, and the market supplies the machinery by which the necessary exchanges can be effected. In directing their efforts, people are guided by the valuations put upon the results by the market. If these valuations are wrong, then to that extent their efforts are misdirected.

Human judgment cannot be made perfect, though perhaps under suitable conditions it may be greatly improved. In the present chapter we shall turn to the narrower subject of the inequality of incomes, and we shall investigate how the inequality arises.

A few big incomes are derived from the personal exertions of people who possess some exceptional skill. They may be great actors or musicians, lawyers, physicians or engineers, administrators, soldiers or prelates. But these are not so numerous as to constitute a serious part of the problem. The biggest incomes and far the greatest proportion of the big incomes are related in one way or another to the possession of property whether in material objects, or in pecuniary rights.

In the first place there are the incomes derived from land. Property in land necessarily includes property in the fixed capital and improvements attached to the land as well as in its natural advantages. There is a fundamental difference between the land ownership which is combined with the business of *using* the land and capital, and that which is separated from it. It is the latter which has the

peculiar characteristics of land ownership. In the former the ownership of land merges in the ownership of the business in which it is used.

Land ownership may breed big incomes in either of two ways. It may lead to the aggregation in one man's hands of the landowner's rights in a large number of different properties. Or alternatively the natural advantages of a property, originally of moderate value, may grow through the development of a trading, manufacturing or residential community, or through the discovery of minerals or other natural resources.

The aggregation of properties is a matter mainly of law and custom. The law of inheritance and the practice of bequest may favour either aggregation or subdivision Feudalism favoured aggregation. Land ownership unrestrained by superior authority or custom is indistinguishable from sovereignty. He who owns the soil is in a position to impose conditions upon anyone who passes over it or settles upon it. Feudalism grew up in a society where the restraints of superior authority had been weakened. It represented a compromise. So much of a superior central authority was admitted as was necessary to secure some degree of solidarity in war, while, subject to allegiance to this authority, the feudal lord enjoyed the attributes of sovereignty in his own land. The land formed a political unit; to subdivide it was to weaken it; to unite two such units was to create a stronger one. Political ambition forbade subdivision. Union could sometimes be secured by inter-marriage between two ruling families.

The feudal system therefore left Europe with a legacy of big estates, which remained big after their share of sovereignty had been taken away. And, wherever land ownership prevails, there is something of the spirit of feudalism. Even when every vestige of legislative, judicial and administrative authority has, so far as legal rights go, been eliminated from the landlord's status, the relation of landlord to tenant still carries with it a certain kind of authority. Landlords value this authority and endeavour to preserve and if possible to extend the lands subject to it. The continuity of existence of a landed property reinforces the conception of the family rather than the individual as the true owner.

Against these feudal traditions are arrayed the tremendous equalitarian forces that were let loose by the French Revolution. The authority of the landlord is not easily reconcilable with the doctrines of democracy, political or social. The

extent to which the new policy has prevailed over the old, whether through legislative measures or changes in custom, varies much in different countries. In old countries the acquisition of agricultural land by the farmer or peasant who works it has been encouraged, sometimes with considerable success, and recently agrarian reforms on a large scale in the direction of peasant proprietorship have been carried through in Eastern Europe. In new countries the tendency has been, in the process of settlement during the past hundred years, to associate ownership with management and work.

But, if the aggregation of landed properties is far less conspicuous than in former times as a source of big incomes, that is really because industry, transportation and commerce have come to play a much bigger part in the economic system in comparison with the cultivation of the soil. From the standpoint of the landowner these developments have offered quite fortuitous increases in economic rent. The lucky possessor of a site suitable for urban development, or of land under which valuable minerals are discovered, becomes a rich man without any effort except such as is necessary to discover the most profitable use that can be made of his land and to find the most lucrative offer among prospective lessees.

Big incomes arise from these increases in economic rent just because they are fortuitous. A piece of land of moderate extent, which when first acquired was little considered among its owner's possessions, suddenly, through the realization of local advantages not previously thought of, becomes by itself a vast fortune.

But striking as the big incomes derived from "unearned increment" are, they are still not the main part of the problem. The primary cause of inequality of incomes is to be found in *profit*. Our examination of the nature of profit in Chapter V has already shown how this must be so. The market, as we saw, though it tends to limit the *rate* of profit, does not tend to limit the *incomes* derived from profits. On the contrary, up to a certain point at any rate, large businesses have an advantage in competition with small, so that the aggregate profits of any trade tend to be divided among few rather than many. The rate of profit in any trade tends to be just not so high as to attract new competitors, that is to say it must not offer, from the moderate turnover that a new competitor can expect to secure, an income large in comparison with that which he could earn in the labour market. The same rate of profit on the large

turnover enjoyed by an established trader will yield a large income.

Many big incomes, it is true, are derived not from profits but from the interest on invested capital. But far the greater part of invested capital is itself accumulated out of profits. Earned incomes are not big enough to provide large sums for investment. The people who are already living on interest can only increase their capital out of savings very slowly (if they care to do so at all).

Invested capital also can always be used as a basis of profits if the owner has the appropriate desires and aptitudes. He can readily find a partner, or otherwise gain access to the charmed circle of financiers, merchants or industrialists.

Profit is a consequence of the organization of human activity through markets Economists usually analyse it into certain constituent parts. The trader who receives profit is a capitalist, and at the same time applies his personal exertions to his business. Profit is therefore said to be composed of interest upon the capital embarked in the business, an extra payment by way of insurance against the risk of loss of this capital, and finally the " earnings of management," the remuneration for the skilled work done by the trader in conducting the business.

This analysis is for some purposes a useful and valid one. But the phrase, earnings of management, must not be interpreted as meaning that the excess of the profits over interest and risk is a reasonable remuneration, or that there is a tendency in the working of the market to bring it into a determinate relation with other scales of remuneration. The trader may be called upon to display skill of a high order. He may work long hours. But the rate of profit has little, if any, relation either to his skill or his hours. Skill and hard work may lead to the extension of his business, and the extension of the business may demand greater skill and harder work. In that way income may be associated with his personal qualities and efforts. But the association is not very close. A certain amount of ability and prudence is necessary to gain or to maintain success in business, but, when supported by experience, and applied to a business which is already a going concern, the endowments of this kind needed are not of a very rare order. In a big business a great part of the skill as well as of the hard work can be obtained from salaried managers and assistants

Undoubtedly some markets require unremitting attention to daily and even hourly variations in prices And nearly

all demand knowledge of the commodities dealt in as well as of the psychology of the dealers. But that does not mean that a trader receiving profits of £50,000 a year need necessarily have greater ability or knowledge than a professional man earning £500 a year from salary or fees.

The phrase, earnings of management, is liable to mislead in another respect. Economists have been too prone to think of profits as being received by a *producer*, and have thrust those of the *dealer* into the background. "Management" suggests the functions of one who is responsible for organizing and directing a business employing labour and fixed capital in production or transport. It is not so applicable to a merchant whose capital is composed of a floating stock of commodities, and whose employees are limited to a few clerks, travellers and warehousemen. The profits of the merchant are derived, not from management, but from judging the state of markets, and finding suitable opportunities to buy and to sell. The profits of the producer depend partly upon the management of his business, upon his efficiency, that is, in keeping up output and keeping down costs, but partly also upon the same skill in buying and selling as in the case of the merchant.

Profits may be increased by circumstances which give the trader a complete or partial monopoly. But many so-called monopolies are really no more than the power which the big trader enjoys in his advantages over actual or potential small competitors. Where this is so, the existence of the monopoly may actually mean a *reduction* of the rate of profit. The substitution of one or more big producers for numerous small ones may lead to the discovery of an elastic demand which makes production on a large scale at a low selling price and a low rate of profit yield a greater aggregate return.[1]

It is sometimes argued that profits are no more than reasonable remuneration for the services of the traders who receive them, because, if the losses of those who fail in business are taken into account, the average incomes of all engaged in trade are moderate. Whether this is a fact or not it is difficult to say. To draw inferences from the yield of ordinary shares of public companies is quite beside the point. Public issues of shares are only made, as a rule,

[1] Monopolists with big individual incomes are also very sensitive to popular criticism of their rate of profit. A small trader receiving an exiguous income from an exorbitant rate of profit on a paltry turnover is immune from criticism.

after the business has become established, and a capitalized profit for the promoters lurks somewhere in the balance sheet. They are only made for businesses where the amount of fixed capital involved is large. Profits play the most conspicuous part in those businesses where capital is small in proportion to turnover, and particularly in commerce as distinct from production or transport.

Statistics indicating the average magnitude of incomes derived from profits are not to be had. Nor, if they were, could they controvert the plain fact that, with a given state of the markets, income is proportioned to turnover, and is not proportioned either to skill or to industry. Even if it be true that according to a fair average, losses being set against gains, the incomes derived from profits are not greater in proportion to the traders' skill and industry than the professional or salaried incomes determined through the competition of the labour market, it is certain that such a result can only be arrived at by averaging a limited number of large incomes with a greater number of failures. These failures are the casualties surrounding the gateway into the favoured citadel of profits. Profits are kept up through the difficulty of entering the gateway, and the combination into a single average of those who are admitted into the citadel and those who are left outside has no serious significance.

The inequality between those who are established in business and the main body of those whose remuneration is determined by the labour market remains. And incidentally it may be pointed out that many of the big incomes derived from other sources are really dependent upon those derived from profits. Not only is most of the accumulation of capital effected from profits, but high urban rents are a by-product of the businesses carried on on or near the sites for which they are paid. High fees are paid for the services of lawyers when the interests of big businesses are at stake. And most of the high professional incomes (outside the public services, where in any case the highest scales are not reached) are due to the existence of very rich people who are prepared to pay at high rates for their amusements or their health.[1]

Capital and profits are related together in two ways. Capital is accumulated mainly out of profits, and, in so far as capital is used in business, the interest upon it is paid out

[1] Of course this is not invariably so. Those for example who appeal to the popular taste in entertainments may receive an enormous remuneration.

of profits. In the Middle Ages the openings for the employment of capital in production, trade and transport were limited. Even at the greatest commercial centres the capital market was in a rudimentary condition. The great merchants who accumulated fortunes, unable to find adequate opportunities of interest-bearing investments, laid out a great part of their money upon possessions pleasing in themselves, great houses, beautiful furniture, works of art.

The industrial revolution pointed the way to an apparently indefinite increase in the amount of capital that could be used in industry and transport. At about the same time the practice grew up of Governments and other public authorities borrowing to meet exceptionally heavy items of expenditure (especially for war), and paying interest to the lenders. The result is the growth of a *rentier* class, who derive an income from capital in the management of which they do not themselves participate. A trader saves out of his profits till he has amassed a capital sum on which the interest is by itself sufficient to provide him with a big income. He can then retire from business, and make what use he pleases of his leisure. If he spends no more than the interest, his capital will pass on his death to his children or to anyone else to whom he chooses to leave it, subject to any limitations that the law may impose on inheritance and bequest. Those who inherit capital wealth are enabled to pass all their lives without any remunerative occupation That does not necessarily mean that they devote themselves to enjoyment and idleness. Every state of society has offered to the rich man of leisure occupations which, though not followed for gain, are none the less of value to the community, and are honoured on that ground. But he is *free* to adopt such an occupation or not, as he chooses. He is free also to enter into business and accumulate further profits. A large capital is not everything, but it is, of course, a great advantage, and trade and finance are always being recruited from the rentier class.

But despite these intimate relations between the trader and the rentier, it is important to distinguish interest clearly from profit. The manner in which interest is determined has already been expounded in Chapter VI.

Economists of the classical school have recently taken to describing interest as the price of *waiting*. " Generally speaking," says Professor Pigou, "everybody prefers present pleasures or satisfactions of given magnitude, even when the latter are perfectly certain to occur " (" Economics of Welfare," p 24). Interest is the price demanded for accepting

a future in place of a present satisfaction, of waiting, that is, for the future satisfaction.

Surely this is very faulty psychology! That present satisfactions are sometimes preferred, no one would deny. But what ground is there for saying that they are, "generally speaking," preferred? There are people who never think about the future at all, but their mentality is not relevant to the psychology of saving. There are others who, though they do think about the future, find their present needs so pressing that they must devote all their means to meeting them; their future needs *may* become equally pressing, but this is not "perfectly certain to occur."

Among those who can afford to postpone expenditure and who think of the future, it is quite as plausible to say that they prefer future satisfactions to present as the reverse. But the qualifying condition that the future satisfactions "are perfectly certain to occur" in any case converts the principle, whether true or false, into an abstraction. No future satisfaction ever is certain, and the motive for saving is very rarely any definite kind of satisfaction. Savings on a small scale are usually intended to be a safeguard against contingencies, such as illness, or loss of employment, or to provide for retirement from work in old age and ultimately for funeral expenses. The thrifty man gives much thought to these future needs, and to suggest that the prospect of receiving interest is required to offset a tendency to underestimate them is hardly tenable.

When we turn to the case of savings on a large scale, we find that these can hardly be described as a *postponement* of expenditure. The intention is not merely to postpone the expenditure of the capital, but never to spend it at all. The interest is to be accepted permanently in place of the capital, and is to supply an income to generation after generation. Who can say whether the people who accumulate fortunes for the sake of a permanent income underestimate or overestimate future satisfaction?

Interest exists, not because lenders need an inducement to postpone expenditure, but because *borrowers* can afford to pay it. A society entirely without interest could be imagined. Suppose that people are accustomed to save in order to provide for future contingencies, and to deposit their savings for safe-keeping with traders of good credit, who can be relied upon to repay them in due course, but who meanwhile are free to use them in business. And suppose further that the opportunities of using capital in business are so slight that all openings for increasing productivity

or diminishing costs by the use of material aids to production and transport are insufficient to use up the savings so deposited. Suppose further that houses are so plentiful that anyone can get accommodation for no more than the cost of maintenance and repairs. The marginal rate of interest would then be *nil.* Yet people would save. It would no longer be possible to endow a family in perpetuity with an income from interest, and an accumulation of capital would, on this ground, be less attractive. But the man with a big income from profits would none the less wish to lay by a reserve of money, which might have to be all the greater because whatever he spent out of it at a later stage would come from capital. The impossibility of securing a perpetual investment income would probably make him more and not less cautious in spending.

The reason why people who save expect to receive interest is not that they underestimate future in comparison with present satisfactions, but that the borrowers find it worth while to offer interest. Traders offer interest because they hope, by the use of the capital borrowed, to realize profits more than equal to the interest. Governments and public bodies must offer interest because they compete in the investment market with the traders, and the price is not too high for them to pay to escape the inconvenience of raising an excessive sum at one time from taxation.

Under conditions where the aggregate amount derived from profits is large, savings are large and the rentier class grows. The growth of savings tends to use up the most profitable openings for investment, and as less and less profitable openings are resorted to, the marginal yield of capital falls. This tendency may be counteracted either by the discovery of new methods of employing material aids to production and transport, or by the opening up of new natural advantages, or by an increased demand for loans from Governments. Thus the rate of interest prevailing in the capital market fluctuates from time to time. But the causes of the fluctuations arise almost entirely on the side of the borrowers.

It may be contended that, even if there is a certain amount of saving which would go on whatever the rate of interest might be, there must nevertheless be some portion which responds to changes in the rate, and that in this portion there is to be found a marginal supply of savings. It has already been pointed out, however, in Chapter VI that certain kinds of savings would be actually *diminished* by a rise in the rate of interest. There is no certainty that

those savings which are stimulated would be the greater, and in any case the effect of changes in the rate of interest on the motives by which saving is guided would seem to be very small. Economists would say that the supply of "waiting" is very "inelastic." But that is merely another way of saying that it is nearly, if not quite, independent of the price offered for it. And if the offer of interest does not elicit a supply of "waiting," to call interest the price of waiting is a misnomer

The growth of the rentier class is fed, as we have seen, mainly from profits. Its growth is cumulative. Nevertheless profits are still likely to remain the principal source of inequality in the distribution of incomes. Profits tend to grow in proportion to total production, even when there is no change in the methods of production. But if capital is growing, that tends to make production more complicated, the division of labour is elaborated, processes are multiplied, materials and products travel over greater distances. When there are more stages at which profits can be secured, the proportionate amount of profits will be all the greater. Thus the same material progress which decreases the rate of interest is likely to increase the total amount of profits.

On the other hand when there are large Government borrowings, the rentier class is increased without any change in the processes of production and transport, and the rate of interest rises.

On the whole the tendency is for profits and interest taken together to form a growing proportion of the total of incomes in any progressive community which is organized through markets. And as they grow, the inequality of incomes becomes more marked. Under primitive conditions, when most people live on the land and provide their own subsistence out of it, a comparatively small proportion of the products of society passes through a market, and profits are correspondingly restricted. Mediæval trade was on a very modest scale; it was confined for the most part to a limited number of articles of high value in proportion to their bulk and weight.

The expressions, "earnings of management" and "price of waiting" are intended to *explain* profits and interest. In explaining, they defend. Certain services are essential and the open market offers a certain price for them. This is merely one application of the individualist principle, that everyone is to receive the fruit of his own efforts. From the valuation of those efforts in the market there is no appeal.

This defence does not necessarily break down upon the

vices of the profit system. The system must not be condemned unless a better alternative can be found. But even if profits are justifiable as supplying the necessary motives to traders, the evils of the inequality of incomes remain.

Here a new line of argument deserves examination. If human judgment could be trusted to select the objects of expenditure wisely, then it may be conceded that the removal of the more flagrant inequalities of income would be an advantage. But in any case *absolute* equality is not desirable. And, in view of the vagaries of human wisdom and folly, great inequality in certain directions may be very desirable As Mr. Hugh Dalton says in his *Inequality of Incomes*, " the ideal distribution would rather be a distribution according to the capacity of individuals, or families, to make a good use of income." But there is very little tendency for the existing inequalities to conform to that principle. In a few cases the same abilities that enable a man to secure a big income qualify him to spend it wisely, but this is far from being a general principle.

On the other hand people who are born rich do acquire the art of spending. They acquire whatever imperfect form of the art happens to prevail in the society around them, but, such as it is, it represents the accomplishments of the community in that direction.

Suppose that the economic power of a community is so limited that, with an approximately equal division of its products, *no one* will be able to live a life much above the brutes. They may go on living from generation to generation unillumined by ideas or by taste, simply working, eating, sleeping and breeding.

Suppose in such a community that inequality of incomes develops, and that there is a leisured class, the multitude of yahoos being depressed to a still lower standard of living to provide the necessary surplus. The increase of their hardships is an evil, but in view of the adaptability of human nature to hardships, is it so great an evil as to outweigh the birth of culture ? Can the community destitute of culture be regarded as worthy of existence at all ? Is it any better from the ethical standpoint than a rabbit-warren or an ant-hill ? The ants and the rabbits may be presumed to be capable of happiness. Take away all intellectual and artistic attainments, and wherein are men their superiors ?

Perhaps the burden of supporting a leisured class would depress the masses below the subsistence level itself. In that case they would die off a little quicker ; their numbers would diminish till, according to the Malthusian philosophy, the

natural advantages of their environment would suffice to support the remnant. In that case the loss would be not in standard of living but in numbers, and after a transitional period there would be no additional misery.

Moreover progress itself depends upon the existence of people with the training and the leisure to think. An equalitarian nation, entirely composed of small peasants who give their whole time and energy to extracting a bare subsistence from the cultivation of the soil, is almost precluded from progress. When the leisured class is created and progress becomes possible, the lot of the yahoos themselves may as a result be improved.

It is not necessary to suppose that the privileged few are a selected stock of superior congenital qualities. Human knowledge is not as yet competent either to select such a stock or to say what social circumstances would tend to select it. The selection may be supposed to be entirely fortuitous, so that the privileged families will not provide any better raw material for progress than the depressed masses. The justification for an arbitrary discrimination is that without it the available resources will be so dissipated among numbers that *no one* will have the opportunity to make anything of life. If a garden has to be tended with inadequate labour, it is better to concentrate upon a restricted area, and let the rest run wild, than to spend vain efforts in trying to reduce the whole to order.

There was an approximation to this type of society in Western Europe in the early Middle Ages. The mass of the people were serfs tied to the soil. They had no prospect but of labour. The surplus above their subsistence went largely to the support of two superior castes, the feudal lords, in whom were the political power and the military leadership, and the Church, who formed the intellectual and cultural aristocracy. The system was not complete There were free cultivators of the soil, who were below the grade of feudal lords, but above that of serfs. And there were free townsmen, including both merchants and craftsmen.

The system contained the seeds of its own destruction. Progress, intellectual and political, gradually made it impossible. As the material resources of society grew, the intellectual monopoly of the Church and the political monopoly of the feudal lords alike broke down. First the monopolies were infringed by the free classes. The Renaissance and the Reformation were signs of their cultural and intellectual encroachments. Finally the dawn of democracy

with the French Revolution ended serfdom and claimed recognition for the rights of man.

The equalitarianism of the Revolution was political, but underlying it was the principle, economic and social, as well as political, that the ends of society must comprehend the welfare of all its members and not merely of a class. This principle has gained something of the power of a taboo. And with good reason The aristocratic theory of society assumes that a proletariat kept down to a wretched existence of poverty and hard work will be deadened and incapable of progress. But human nature is not so constituted. In some directions the deadening effect is painfully evident, but experience with slaves, serfs, and other downtrodden classes has shown again and again that men cannot be degraded to the level of the brutes. They may become inured to hardship and privation, and morally, intellectually and artistically stunted. But human beings they remain, and their spiritual and emotional life cannot be barred out.

In any case the defence of the mediæval castes, whether valid or not, is not appropriate to the inequalities of modern civilization A state of society in which the proletariat are ignored, like cattle or yahoos, is no longer thinkable. Nevertheless we still have to meet a form of the argument adapted to suit the circumstances of an advanced civilization. Granted that a tolerable existence immune from all the major physical distresses and privations ought to be secured so far as possible to everyone, is it not still true that a limited leisured class of great resources is capable of achievements which a busy comfortable equalitarian society would never dream of ? Without them a tradition in the use of great wealth, untrammelled by the interference of superior authority, can never be created at all. Does not such a tradition introduce something of value, and unique in its way, into human life ?

He would be a bold man who would contend that the actual tradition in the use of wealth, and the actual standards of expenditure set by rich men, as we know them, would support such a defence. But that does not dispose of the matter. Better standards have sometimes existed in the past. At some time in the future there may be better standards still.

It may be contended that inequality is unjust. But, if that is so, we cannot secure justice without actual equality in respect of wealth. It is difficult to see how equality can be arrived at, or even satisfactorily defined. To say that everyone should have resources according to his needs is

an intelligible principle in the distribution of defensive products. But as soon as we apply it to creative products, we open the door to almost indefinite inequalities. A man may " need " a gallery of old masters, a wide and solitary park, or an orchestra of a hundred highly skilled performers.

The principle of justice is not altogether applicable here, because wealth is too restricted a sphere for it. The appeal to justice in the distribution of wealth is inspired by the prevalent exaggeration of the importance of money in a money-making world.

With our assumptions (Utopian perhaps) of a tolerable standard of living for everyone and a high standard of taste among the rich, there is room for a class of wealthy epicureans endowed with an acute appreciation of the really good things which may be produced by the economic activity of man and with sufficient material resources to procure them in plenty

CHAPTER XX

INDIVIDUALISM AND PRODUCTION

HITHERTO our criticisms of the economic system have been applied exclusively to the ends pursued. In the present chapter we shall pass to an examination of the means used to attain the ends.

The ends are to be found in consumption ; the means in production. In Chapter IV we defined production as action which results in the existence of something (whether material or not) which did not exist before. But this is a wider definition than would be appropriate to the term as ordinarily used in economics. To the economist production means action which results in the existence of something *marketable*. So defined, it is a concept, like wealth, derived from the market. In Morris's *News from Nowhere* people make things for the love of making them ; there is a superfluity of everything. Nobody buys or exchanges, for everyone can take and consume what he pleases. The marginal utility of everything is *nil ;* there is therefore no wealth, and there is no production, if production is limited to the production of things marketable

Production in this limited sense is the only kind of production that individualism sets out to promote. People are to do what they are paid to do, and they must be paid out of the sale value of the product.

It is on this side that individualism, within its limitations, is most successful. Given the end, in the shape of marketable products, the means for securing the end are on the whole efficient. The dealers, the producers, the capitalists and the workmen, who have to co-operate for the purpose, have inducements which are in general found adequate to lead them to take the action required. The workmen cannot live without working, or if they can live under the poor law (itself an alien excrescence on individualism) that is a refuge so inferior to an independent life that they are not ordinarily satisfied with it.

The producer has a free hand to extract from his business whatever profit he can make it yield. Of whatever improvements his ingenuity and assiduity may devise, the whole gain goes to him. He has the strongest possible pecuniary incentive to make the productive process as economical and as efficient as possible. At the same time the market price, so long as competition is free, tends not to be higher than the cost of production under reasonably efficient conditions, *plus* a normal profit. Each producer is compelled to adopt whatever improvements other producers in the same industry have started.

This applies not only to purely technical improvements in the productive processes, but to every device that makes for efficiency, for example, in the management and control of the workpeople, the situation chosen for the business, or the size of the business unit. In every direction the money-making motive is successfully appealed to, and the producer responds by making his business as efficient as he can. Incapacity will probably mean failure, so that there is a process of selection always going on among producers, and preventing a lowering of the standard of efficiency. The efficacy, however, of this process of selection is impaired in so far as success depends upon pure luck.

Wherever markets signal a demand for any kind of commodity, producers soon come forward to supply it at as low a cost as technical development permits. New products and new processes are continually being planned, and, as soon as an assured demand is in sight, people will be found to start a supply. It is the merchant's function to watch demand, and to order supplies from the producers A producer who is in direct touch with the retailers is in that respect acting as a merchant. All production is in some degree speculative, in that it must precede consumption by a considerable interval. The merchant takes the risk of forecasting demand The producer works up to the orders given by the merchant, and therefore knows that he will be able to dispose of his product. But he does not escape the risk of his works sometimes being under-employed or even entirely idle.

The technical problem of supplying a product at a minimum of cost in response to a steady demand has been fairly satisfactorily solved. With a fluctuating, a spasmodic or a temporary demand, on the other hand, serious waste occurs. This is not peculiar to the factory system with production organized in large units equipped with expensive plant, though under those conditions it is especially con-

spicuous. Even small home-industries are exposed to the same evil, in that a part of their stock of human skill is being wasted when they are under-employed.

To the inevitable waste due to real fluctuations in demand is added a quite unnecessary waste due to the so-called cyclical fluctuations. I have expounded elsewhere[1] my views as to the trade cycle, and have endeavoured to show that it is traceable to a maladjustment of credit, which ought to be remediable. An expansion of credit increases the supply of purchasing power, accelerates sales, raises prices and swells profits. A contraction of credit decreases the supply of purchasing power, retards sales, lowers prices and curtails profits. Production has to be increased to meet increased demand in the one case and to be diminished as demand declines in the other. The fluctuations in the volume of production are just as real and as wasteful as if they were occasioned by real changes in the intensity of demand for the particular products, instead of by disturbances in the machinery of exchange.

Even where demand is steady, production under the individualist system is not faultless. In the very common case where the output of some manufactured product can be largely increased at little extra cost, there is a danger that unrestricted competition among producers may bring about a glut. Glut is a phenomenon which may occur with all commodities ; a point is reached at which demand ceases to be stimulated by reductions of price. Demand is satiated, and "marginal utility" approaches zero. If that occurs, there must somehow be a restriction of output. If it is not effected by concerted action among the producers, then the restriction must come about through some of the producers going out of business. Equilibrium will only be reached when the restriction is sufficient so to raise the price as to cover the producers' overhead expenses and provide in addition a normal profit.

An example will make the situation clearer. Suppose plant is installed to produce 120,000 a month of a certain article at a cost of 6d. each, and that 240,000 a month can be produced at a cost of 3½d. each. Then the *additional* cost of the extra 120,000 a month is the difference between 120,000 times 6d., or £3,000, and 240,000 times 3½d. or £3,500 ; it is £500 or 1d. each.

But it may be that, though 120,000 a month could be sold for 6d., 240,000 could not be sold for more than 2d.

[1] See my "Good and Bad Trade," "Currency and Credit," and "Monetary Reconstruction."

The extra 120,000 only cost 1d. each, and people are prepared to buy them at 2d. each, yet because they drag down the price of the first 120,000 to 2d., the effect will be that the whole business is carried on at a loss.

Sometimes the additional supply costs practically nothing at all. Suppose a road is made to connect two villages. What it supplies is the means of communication between them. It is physically capable of supplying *all* the means of communication that they need, and, if they use it freely and without payment, the "marginal utility" of the use of it will be *nil*. If the road has been made by private enterprise, the proprietors of it will make a charge for the use of it in the form of tolls. The lower the tolls the greater the traffic, but a point is soon reached at which the increase in traffic ceases to compensate the reduction in the tolls, and the reduction means a reduction in the gross receipts of the proprietors. For the road to yield its maximum usefulness, the tolls ought to be fixed so low that a further reduction would not yield an appreciable increase of traffic. In that case the people who would have been willing to use the road even at the cost of high tolls, get off with the same low payment as the rest. The advantages to them of using the road are none the less, and their gain is the proprietors' loss.

Similarly, if an entertainment is given in a hall which is big enough to hold all the people who would come to it on any terms, the maximum advantage is attained if the payment exacted is so low that all will come. To cover expenses and secure an adequate profit, a price must probably be fixed which will deter a certain number of people from coming, although, the entertainment once undertaken, their enjoyment would have cost nothing additional at all.

Examples might be multiplied. The royalties of an inventor or an author tend to diminish the use made of their work, while the payment does not represent any extra cost on each occasion when it is made.

Another case in which individualism fails to ensure the most economical methods of production is where the boundaries of landed properties do not correspond with the most suitable subdivision into productive units. Where agricultural estates are large, and the landlords have unfettered discretion in deciding what parcels shall be leased, the landlords' self-interest tends to promote a suitable subdivision. But where the separate properties themselves are small relatively to the most suitable productive unit, the best subdivision would often cut right across an estate

boundary. And the small peasant holding is often too small to give adequate scope to the labour of the holder and his family. The peasant is led to increase his resources by a more and more intensive cultivation, which in reality involves a waste of labour. He is overworked, and yet remains poor. The defects of character, the narrowness and avarice, that develop in peasant communities are perhaps partly due to this cause.

The waste due to unsuitable subdivision is more striking in mining than in agriculture. Landowners' boundaries are usually fixed by historical causes, and probably correspond fairly well to the agricultural requirements, at any rate, of a past epoch. They have no relation whatever to the requirements of minerals beneath the surface, except sometimes in a new country which has only been settled after the minerals have been discovered. The result is that a mining enterprise may have to make a series of separate bargains with different landlords, and the concessions obtained by one such enterprise may be separated from those of neighbouring enterprises by boundaries so placed as to interfere seriously with the most economical working of the minerals. Difficulties of this kind were among the principal reasons that led Mr. Justice Sankey and the miners' representatives on the Commission of 1919, of which he was chairman, to recommend the nationalization of coal mines.

In the preceding discussion we have been employing the idea of "cost." The task propounded is always to produce at the lowest possible cost in response to the demand signalled rom the market. That the power of that demand is based on market value and not on ethical value is not, for the moment, in point. We are considering whether, given the demand, the supply is produced at the least cost. But what, it may be asked, is cost?

Cost itself is measured by the standards of the market. The producer reckons cost in terms of labour and materials and interest on capital. The materials are themselves products, of which the cost is to be analysed in the same way. In the last resort costs are composed solely of labour, interest and rent. Labour is here to be taken in a wide sense to include all human effort, and rent includes the payments to be made to the owners of the land from which the materials are derived by growth or extraction. Interest is the payment for the use of capital. The first cost of the capital is composed of the same ingredients as the first cost of anything else, and the rate of interest is based on the efficiency of the capital in saving effort.

Rent likewise represents a saving of effort, and the same is true of such part of the salaries and "earnings of management" as may be paid for efficiency in directing the services of workmen to the best advantage. Ultimately cost means cost of human effort.

The price of human effort is settled in the labour market. We found that in the commodity markets there is no specific attribute of things which is measured by price. Utility is an abstraction. In the labour market we still cannot pretend that the market rates of remuneration are an *exact* measure of any attribute of human effort. Nevertheless there is a sense in which we can say that they are an approximate measure of effort. In the labour market all forms of labour are ultimately in competition with one another. All are subject in some degree, though imperfectly, to its equalizing influence. There tends to be at any place a determinate cost for the employment for a unit time of the labour of a competent able-bodied adult workman, whose skill, natural or acquired, is not so special as to command a scarcity value. An hour's work of a workman so defined supplies a standard unit of effort, with a determinate money value, and the cost of any product can be expressed in terms of such units. The actual amount of effort required to produce it will not be a homogeneous measurable total of this kind. While a part of the requisite effort will approximate to the standard, a part will be the work of people whose skill commands a scarcity value. But much of this specially valuable skill is not incommensurable with the standard. For the value of skill in organization and management is realized mainly in the economizing of costs, which can be expressed in terms of standard labour. In this respect such skill resembles capital. The salaries paid for it, like the interest on capital, approximate to the cost-saving capacity of the marginal supply of the skill.

Manipulative skill is different. In the particular case where the standard workman can perform a task, and a more skilled man can do it better, the skill of the latter might be expressed, like the skill of the manager or organizer, in terms of the standard units of effort that he can save. But that is a special case. More generally the skilled workman accomplishes something that would be beyond the capacity of a greater *quantity* of unskilled effort. When that is so, the remuneration of the special skill reflects the value in the market of the finished product in which it is embodied. At this point the standards of the commodity markets begin to influence the remuneration of effort, and costs cease to

measure mere quantity of effort. Perhaps we should say that effort ceases to be measurable at all.

Nevertheless it remains true that costs *approximate* to a measure of the quantity of effort. And within the same limits of approximation it is true that the individualist system tends to provide the things that the market asks for at the least possible cost of effort. The price paid by the consumer exceeds this cost, because it includes the profits of the producer and the dealer. But that only affects the *distribution* of the product as between one consumer and another. The recipients of profits are themselves consumers. If profit ever represents superfluous effort, it is in those cases where a producer or a dealer is performing on a small scale tasks which he could perform with very little extra effort on a much larger scale. It is the small incomes derived from profit, not the large, that involve waste of effort.

The amount of effort that a community can apply to production is not unlimited. It is broadly true to say that whatever effort is applied to one purpose must be diverted from others. Waste of effort in one direction means the curtailment of production in others.

If a saving of effort is not applied to increased production, it makes possible an increase of leisure, which may well be more beneficial. In so far as individualism secures economy of effort, this is a very real gain—much more real than the maximum of "utility."

Subject to all the necessary corrections, adjustments and qualifications, we regard cost of production as expressible in terms of standard workmen's time. But we have said nothing as yet as to the conditions in which work is carried on. One task may be interesting and pleasant; another, occupying the same time, may be disgusting, degrading, fatiguing, tedious, or dangerous. The classical economists endeavoured to relate the remuneration of labour to the marginal "disutility" of the occupation. But in reality it is not at all the rule for the workman to be compensated by an extra money payment for the incidental disadvantages of his calling. Quite as often the pleasanter occupation actually carries higher pay, and social convention reserves it for workmen of a superior grade.

Perhaps the outstanding defect of individualism in the sphere of production is that it affords very little inducement to a producer to take care of the conditions under which his employees work. It is not merely a question of dangerous or unhealthy or uncomfortable conditions. Such faults are obvious enough to evoke complaints, and to call for

action by the State or for organized pressure from trade unions. But working time is so great a part of an average man's life that the manner in which he spends it is of great consequence to his well-being. Dull work in ugly surroundings is itself a serious evil and remains so when the workman himself is habituated to it and does not mind it. Industrialism has involved a deplorable increase in the amount of such work, against which it would hardly be possible for organized labour to make a stand, even when the individual workmen have enough initiative and imagination to desire other conditions.

CHAPTER XXI

WEALTH AND POWER

IN the last four chapters we have been criticizing the pursuit of wealth in an individualist community as a means of attaining welfare. The kind of welfare we have been discussing is that which the individual gets from spending his income. The questions raised, as to whether money is well or ill spent, are those which have to be settled every day by the careful housewife or by the man of culture. We have endeavoured to make a comprehensive and dispassionate survey of these problems from the detached vantage point of ethical philosophy.

But if we turn to the great practical controversies of economics, and to the measures to which they lead, we find as little trace of the problems of the housewife or the man of culture as of ethical philosophy. Whereas the market gives effect to the desires of a great number of independent individuals, who act without leadership and without cognizance of one another's motives, the authority of the State is delegated to a limited number of people, who are in a position to plan a policy and to concert measures for carrying it out.

Were the individualist ideal realized, and the activities of the State confined to just so much interference with the freedom of each individual as were necessary to secure the freedom of the rest, this part of the economic problem would be a secondary matter. But we have shown in Chapter XII and Chapter XV that that cannot be so. In Chapter XV more particularly, we have indicated the transcendent claims of the State on the score of national security.

The philosopher may prove that wealth, as we know it, is not the means of attaining welfare, and that it is a mere complication of futilities, but he will make little impression on the statesman. To the statesman wealth is the indispensable means of national power. Other factors indeed con-

tribute. Numbers, courage, physical endurance, military skill, power of organization, all count. But all may fail for lack of wealth.

All forms of wealth are not equally contributory to national strength. By wealth we mean marketable goods and services National strength, it will be remembered, means strength in *war*, actual or potential. What then can a nation at war get from the markets?

Its own markets must be regarded as a piece of internal organization. In order to make its resources, human and material, available for war, it has the choice of three principal methods: it may make an appeal for voluntary effort; it may secure the services it needs by compulsion; or it may purchase them through the market. Voluntary and compulsory services, however, are in no case a complete solution of the problem. For those who render these services, even if they do not receive the inducement of the remuneration which the labour market would offer them, must yet be fed and clothed and provided with the necessary equipment. These commodities might themselves be provided by voluntary or compulsory effort. There would then be great numbers serving the State without full market remuneration, the major part of whom would be engaged in supplying the necessary subsistence of the remainder. Only these latter would be available for the direct military effort, either serving themselves against the enemy, or producing munitions and warlike equipment. In order to secure the maximum national effort through this type of organization, *practically the whole population* must be included in it. If human nature were so constituted that either voluntary enthusiasm or legal compulsion could be relied on to elicit the best efforts of the people, the method would be effective. But that essential condition is not fulfilled. So far as those who face the rigours and dangers of actual military service are concerned, the motives of the market are indeed out of place. In the past mercenaries have played a great part in war, but with the growth of national sentiment they have dropped out. Nowadays, at the point at which the devotion of the patriot fails to respond, compulsion enforced by military discipline is called in aid.

But when it comes to the ordinary processes of production and transport, military discipline is less effective than the customary motives of the market in eliciting effort. The best way to secure the maximum surplus of disposable wealth is to leave the economic organization of society

substantially unchanged, but to raise money for the use of the State by taxation and borrowing.

The withdrawal of this money from the consumers diminishes the demand for goods and services on their part, while the State comes into the markets with an equal demand in its place. But the things which the State demands are not identical with the things which the private consumers dispense with Some of them are identical, but not all. The people who are taken into the direct employment of the State require to be fed and clothed as before, and certain of the ordinary facilities of life, especially those of transport, are directly adaptable to the uses of warfare. But such adaptation is limited, and the main part of the economics of warfare consists in the change over of a part of the productive resources of the country from supplying the needs of the private consumers to supplying the needs of war

Prominent among the needs of war are two, munitions and transport. The production of munitions is a service entirely outside the needs of peace, and some provision has to be expressly made for it during peace time with a view to possible wars. As industrialism has developed, the plant required for the manufacture of munitions has become more and more elaborate; it has become more expensive and less capable of being improvised in an emergency, and on both counts the peace-time burden has become heavier. This is particularly true of war-ship construction. Though a war-ship includes in itself the power of transport, it is primarily not a means of transport but a weapon. At some past periods merchant ships have been readily convertible into war-ships, and war-ships have been conveniently used in commerce. This was so in the 16th century when the ocean-going sailing ship displaced the galley in naval warfare, and when practically all merchant ships carried artillery for self-defence. But technical specialization soon reasserted itself, and from the time of the Anglo-Dutch wars of the 17th century all the great maritime powers have relied upon war-ships designed as such, supplemented only in a minor degree by adapted vessels, such as the privateers of the 18th century and the merchant cruisers and fleet auxiliaries of more recent times.

Munitions and war-ships may be manufactured either by private producers for sale to the State, or by the State itself. In time of war, when the productive capacity of the country for these purposes is strained to the utmost, the State is almost bound to step in and take control of the private producers. It cannot afford to rely on the ordinary

motives of the market, which would stimulate production only by the offer of high profits. The State must use its authority to lay hands on whatever plant is suitable or adaptable to the production of the supplies it needs, and to insist on that plant being worked to its maximum capacity. So far as capital and business organization are concerned, the change over from normal production to war-time production will thus be effected by compulsion. In some states of society compulsion can also be applied to labour. But under modern conditions this is hardly practicable The State has to buy labour in the market, and stimulates the response to its demands as best it can by appeals to patriotism.

Transport differs from munitions in that what is required in war is an extension and elaboration of a service that in any case exists in peace-time. Military operations require the concentration at the vital point or points of adequate numbers of equipped and organized men. If the war is a real trial of strength, and not a mere expedition against an insignificant enemy, no numbers are adequate short of the greatest possible. Concentration means not merely the assembly of the men themselves at the vital points, but the maintenance of the necessary flow of supplies and reinforcements. The vital points are perpetually changing. They are the meeting points with the enemy ; they move irregularly as a result of the efforts of both sides to attack one another's territory and resources, and to defend their own. The problem of transport in war is therefore one both of concentration and of movement.

In order to gather up material resources from the places where they are produced and carry them to the ever moving military front, use must be made of the same communication facilities as in peace-time. Thereby supplies are concentrated at the regular interposts of the country. The front itself, however, is a temporary city ; it is a market, which may in the course of operations move away from the peace-time lines of communication, and must then be served through improvised communications and improvised interposts.

These improvised communications are an additional war-time requirement, like munitions, and have to be provided for to some extent in peace-time. Before the advent of mechanical traction the problem was solved, so far as land communications are concerned, mainly by horse traction. The mobility of an army depended upon the number of horses and horse-drawn vehicles which it could procure, and every standing army possessed a considerable

amount of such transport, which had to be supplemented in case of war by requisitions and purchases from civilian sources.

Nowadays military considerations have to be taken into account in the construction of railways, so that the peace-time system of communications and interposts is itself planned in part with a view to war conditions.

In view of the need for the mobility of resources in war, it is obvious that a country with a highly developed marketing system has a great advantage. If in any case under normal peace conditions most of its products are sent to interposts to be marketed, then one stage in the process of concentration is already provided for. Along with a marketing system goes a banking system, so that the State finds ready to hand the means of collecting funds from the taxpayers at the marketing centres, and spending them there on the purchase of the necessary supplies

A country in which the division of labour is less complete, and which is composed of small communities each supplying its own needs, will be faced with formidable difficulties The country's resources may be great, and the people may be luxuriating in plenty, and yet it may be possible only to concentrate very meagre supplies for an army.

This is not the full extent of the contrast. Up to this point we have been considering marketing only as a piece of internal organization. But marketing is also the basis of external trade. The power of a country for war can be greatly reinforced through external trade. In the first place, to some extent, instead of changing over its productive resources from peace-time commodities to warlike supplies, it can produce for export, and use the proceeds to buy these supplies in the markets of the world. The waste involved in adapting its productive power to new needs is thus reduced. The adaptation is made in great part in the countries from which supplies are imported, and, being spread over a greater area, entails less dislocation.

A country with access to foreign markets can add still further to its resources for war by borrowing abroad or selling some of its capital assets in foreign investment markets. Thereby it can receive imports without having to send any exports in exchange (until payments on account of interest or principal of the sums borrowed become due). These additional imports need not be wholly or mainly actual warlike supplies ; they may include ordinary commodities for the support of the population, setting free the productive power that would otherwise have been employed

upon such commodities, either to manufacture warlike supplies or to release men for military service.

A country which does not carry on a great foreign trade may, no doubt, be able to borrow abroad. But its power to do so is likely to be very limited. For its capacity to pay interest on the sums borrowed, and eventually to repay the principal, depends ultimately on its power to export, and foreign lenders will take good care not to lend it more money than its commercial capacity will enable it to repay.

A great trading country is likely to carry on a large part of its commerce by sea. Sea transport is far the most economical means of carriage for bulky goods and for long distances. A country which possesses a large mercantile fleet has ready to hand a very potent instrument of military transport. The value of it in any particular war depends upon the circumstances. If there are no objectives of military importance access to which can be gained or facilitated by sea, then of course it counts for nothing. And, even where such objectives exist, the sea route cannot be used unless the necessary naval power is available to defend it. But to a country with extensive maritime commerce objectives of this kind are likely to possess importance, and it is likely therefore to support its power of sea transport with the necessary naval power.

And not only does the great trading country hold its material resources in forms most suitable to be drawn upon for war, but it is likely also to have the greatest resources. After all that has been said as to the importance of profit as a source of individual wealth, it is hardly necessary to elaborate the point again. Here we are viewing this wealth from the standpoint of a government which has to procure supplies for a war. The big individual incomes can be tapped by taxation. From them comes also a supply of investible savings which can be drawn upon by the issue of loans. With the big commercial incomes will be associated an organized capital market, which will be in contact with the world capital market, and through which existing investment securities can be sold to foreign investors. If, as is likely to be the case, the country has been investing a part of its savings abroad in peace-time, the Government can draw on foreign supplies by merely diverting this part to its own loans.[1]

Some of these elements of strength in a great trading country have only gained importance in modern times.

[1] We shall return in Chapter XXIV to the subject of the strength which a country derives from an investment market with international connexions.

But the fundamental power of mercantile profits has played a great part in political affairs, and has coloured the economic policy of governments from the beginning of history. This was the result not of theory but of experience. States faced with the problem of financing wars, especially wars beyond their own borders, were driven by the logic of facts to approach the great exporting merchants.

In the Dark Ages the trade of the Mediterranean was mainly in the hands of the two great States, the Roman and Arab Empires. The barbarians of Western Europe had destroyed too much of the Roman provinces in which they settled to allow of the survival of an effective economic organization, and it was only gradually that new cities grew up or old cities were restored at the essential interpostal points. The earliest developments were at the points through which the Byzantine and Levantine trade passed to reach the growing populations of Italy, Germany and France.

The most profitable trade is not necessarily between the richest communities, but between those in which economic conditions are most dissimilar. Venice, Genoa, Marseilles and Barcelona grew rich because through them the luxuries produced in the civilized East were sold to the barbaric feudal communities in their hinterland. The business of marketing led to the evolution of new interposts in the hinterland. Financial centres such as Florence, Lyons, Nuremberg and Augsburg grew up.

The Roman Empire of Constantinople was a populous and highly organized state. From before the time when its separate existence began with the loss of the Western Provinces, it had attained the economic development that was then technically possible. Such further material progress as occurred was slight ; in fact it is probable that as a result of many wars, some of them disastrous, there was actual deterioration even before visible decay set in.

The barbarians of Western Europe on the other hand started from almost primitive conditions, and, during the six centuries which intervened between their definitive occupation of the Roman Provinces and the Crusades, they were making steady progress towards civilization. In course of time they were bound to outstrip the Roman Empire. A prolific population from a vigorous stock, settled in an extensive and productive area, only needed a system of communications and marketing facilities to become wealthy

The Crusades mark a stage in the advance of Western Europe. A war against the encroachments of Islam embodied a new political unity in Western Christendom. The bond

was found only in a common spiritual allegiance, and there was not the single sovereignty characteristic of a fully organized State. Nevertheless for the moment Western Europe set out to act as a single State, and to effect a single military concentration.

The feudal lords, confronted with this task, had recourse to the merchant cities of the Mediterranean, not only for shipping, but for the essential service of making their resources available at the distant military front. The merchant cities eagerly joined in. But their motives were different from those of the feudal lords. To the feudal lords the enterprise was essentially one against an alien who had infringed their taboos, and desecrated their holy places. To Venice, Genoa or Pisa on the other hand it was an opportunity in the first place for re-establishing the access they had had to the interposts at the eastern end of the Mediterranean, which formed a vital link in the growing trade between Western Europe and the East, and secondly for going further and getting into their own hands the share of the trade of those interposts which had formerly belonged to the Byzantine merchants.[1]

Merchants who become familiar with foreign peoples learn to tolerate differences in taboos. As trade developed, the antipathy of the Christian merchants of the Mediterranean cities to the infidel Moslems softened. They still preferred Christian rule to be established in the markets with which they traded, but that was because they feared that infidel rulers would themselves be led into hostility by their taboos.

The early Crusades met with substantial success. The feudal lords vindicated their taboos and occupied the holy places. The merchant cities secured precious commercial privileges in the Syrian ports. The effect was to excite the jealousy of their Byzantine rivals, and at last the two motives, the taboos of the feudal lords and the commercial ambitions of the merchant cities, came into conflict. The merchant cities prevailed, and the result was that *reductio ad absurdum*, the Fourth Crusade, when Venice carried the feudal lords in her ships to the conquest of Christian Constantinople. Such was the power of the purse. So indispensable was the wealth of the merchant cities that they could turn aside the devotees from the holy places. It was merely the logic of

[1] It is possible that the commercial motive counted for a good deal more than appeared on the surface. Jerusalem had been in the hands of the Moslems for centuries. No doubt the Turks, when they took it, were less tolerant of pilgrims, but the outstanding new development was that they took Syria, which had till then been Byzantine, as well.

facts. The Crusades depended upon the resources of the merchant cities; the resources of the merchant cities depended on their markets; their markets had to be freed from their rivals. It was another instance of the general principle that war makes the strong stronger and the weak weaker. There had been a balance of power between the Italian Republics and the Byzantine Empire. The balance was disturbed; the fortune of war declared on the side of the Italians, and there was no stopping place short of the complete subjection of the Byzantines and the seizure by their rivals of all the local advantages which they had possessed.

All through the Middles Ages we find the same dependence of the warlike feudal leaders upon the wealth of the merchant communities. Edward III found the means of financing a great war overseas in the wool exports which were then the mainstay of the wealth of the English. The financial strength of the English merchants being at the outset insufficient, he employed the international bankers of Florence. By the instrumentality of the wool the proceeds of taxes in England could be transformed into credits at the Flemish interposts which formed a convenient base for the English operations.

Among the tremendous changes which mark the transition from the mediæval to the modern world at the end of the 15th and the beginning of the 16th century, the greatest in the economic sphere was the initiation of ocean-borne commerce. On the one side Europe gained access to the almost untouched material resources of the two American continents. On the other a new link was set up between the three great aggregates of population in the old world, Europe, India and China. The importance of the ocean route between Europe and the East was greatly increased by the renewed intrusion of the Turks, who were less appreciative of commerce and more devoted to the taboos of Islam than the Saracens. Trade by the old routes through Syria and Egypt became less free at the very time that the new route round the Cape of Good Hope became available.

From the 16th century onwards we find a change. Great commercial states in Europe wielding formidable naval power, compete for markets and for the actual sovereignty of territory in the remotest parts of the world. The change is perhaps mainly one of scale. Portuguese, Dutch, French and English factories and settlements in the East and on the African coast were not in the first instance different in kind from the Venetian, Genoese, Provençal or Catalan settle-

ments in and around the Mediterranean. The primary object was always trade. Military power was added to defend the trade, and finally military power, in some cases, though not in all, led on to sovereignty.

Tropical and Southern Africa and North and South America differed, however, from the Mediterranean coasts and islands in being so sparsely peopled and so little developed as to offer a field for colonization. The ocean Powers of the 17th, 18th and 19th centuries resembled the Mediterranean cities of the Middle Ages in their sedulous search for markets, but their opportunities in some ways resembled more closely those which came to the Greeks and Phœnicians in an earlier phase of history, when the Mediterranean still presented a field for colonization.

The ocean Powers differed in another vital respect from the Mediterranean cities. They were not purely mercantile communities, interposts surrounded by a mere glacis of open territory. On the contrary they were great national states including all branches of economic activity. They were producers as well as dealers in commodities, and combined the active liquid resources of great interposts, with the reserves, human and material, of a population spread over a wide territory. This was particularly true of France, England and Spain. Holland and Portugal were more restricted in territory, but even Holland, though in the end unable to compete in power with her bigger rivals, was always quite different in type from a mere city state.

The growth of these great national states completely put an end to the mediæval conception of Christendom. Probably that conception in any case could not have survived the intellectual movement embodied in the Reformation. But the Reformation itself was complicated by tremendous political cross-currents. The Papacy, by granting a monopoly of the New World to Spain and Portugal, turned the other claimants to ocean power, more especially England and Holland, into irreconcilable enemies. Religious feeling became intricately tied up with national feeling, but national feeling got the upper hand, and soon became the paramount motive of all political leaders. National feeling meant the desire for national strength. The principal source of national strength was recognized to be wealth, and wealth in the form that counted most was to be obtained from markets.

It is instructive to compare the history of the trading communities that were merged in great nations, with those which continued up to the end of the 18th century as city

states. The Italian republics had in any case passed their climax. They still depended on the Mediterranean trade, which, since the advent of the Turks and the opening up of the ocean routes, had become merely local, and even there they were exposed to the rivalry of the ocean Powers.

But on the other side of Europe there were trading cities which were full of vitality. Germany failed to coalesce into a great national state till well on in the 19th century, and the Hansa towns remained till then city states. The result was that they never took part in the colonization of the New World, and remained to a great extent excluded from distant markets. Hamburg and Bremen remained interposts for the trade of Northern Germany and the Baltic, but their relations with the New World and the East were for the most part not direct but through English and other intermediaries.

When commerce became world-wide, the field of profit was enormously increased. The ocean-going sailing ships of the 18th century were capable of carrying a great volume of commerce at a low cost and with tolerable regularity and safety. The profits of the mediæval Mediterranean trade had been derived from commodities which were consumed in small quantities such as silk, jewels, furs, amber, pepper, ginger, camphor, cochineal. The profits were high, but the turnover was small. Trade existed in grain, and timber, but it was necessarily very local. The trade in sugar and cotton, though not unimportant, was on a very restricted scale.

Ocean-borne commerce was soon extended to new commodities formerly unknown to Europe. Tobacco, tea and coffee became the foundation of huge fortunes. Sugar and cotton acquired a new importance.

The long conflict of the mercantile powers culminated in the Napoleonic wars. In the first instance those wars were mainly Continental. Napoleon was facing Austria, Russia and Prussia, powers with no world-wide trade ambitions He took the minor states of Germany and Italy in his stride. When he turned Spain and Holland into subject kingdoms, he was not thinking of them as rivals or partners of France in the great race for markets and colonies. In fact that race had already been run and lost. It had been gained by English naval power. The French navy had been mortally disintegrated by the Revolution, and had not experienced a new birth like the army. Napoleon's Continental conquests led him to a deadlock. England with her naval supremacy was unassailable, and, with the resources of a world-wide

trade at her command, was always in a position to foment renewed resistance in any part of the Continent.

He sought escape in an economic war. England's wealth, he argued, was derived from her position as an interpost for the distribution of colonial products and her own manufactures to the dense population of Europe. Europe could, at a pinch, dispense with both classes of products, and England then, deprived of this one all-important market, would no longer be able to trouble him. She would no longer have the great resources of an interpost, but would be reduced to importing commodities from the New World and the East for her own consumption and paying for them with such of her manufactured products as she could sell in exchange.

Accordingly Napoleon instituted the Continental system. He forbade all his subject states of the Continent to import anything whatever from or through England. Here was the most unqualified recognition of the power of trade in war. It was the exact reverse of the classical idea of a blockade. The essential purpose of the blockade of a fortress or of a city is to prevent supplies going in. Napoleon's blockade was to prevent supplies coming out. He did not hesitate to give licences to French traders to send grain to England when the crops failed in 1810, for this, he reckoned, would actually further the purpose of the Continental system.

Napoleon's plan failed. That was partly because he could not count on an absolutely rigorous and honest administrative service to enforce it, partly because he encountered open resistance, especially from Russia, partly because he over-estimated the importance of the European market to English trade. But the failure was not due to any flaw in the principles upon which the Continental system was founded. The revival of resistance on the Continent to the Napoleonic regime was made possible by English resources. English trade, though embarrassed by the Continental system (and also by the quarrel with the United States), was not essentially injured. The formidable reservoir of liquid wealth which Napoleon feared proved in the end the undoing of his Empire.

CHAPTER XXII

MERCANTILISM AND THE HUNT FOR MARKETS

WHEN the economists of the Classical School, from Adam Smith onwards, worked out their theories of welfare based on wealth, they found a rival theory in possession of the minds of practically all those who were responsible for the guidance of national policy. This rival theory was Mercantilism. Mercantilism was not built on any intelligible philosophic foundation. It recommended the fostering and development of *trade*. But it advocated exports rather than imports, selling rather than buying, production rather than consumption.

Judged by the standards of utility, exports are the means of acquiring imports, selling is only a preliminary to buying, production is nothing except in so far as it culminates in consumption. If the mercantilist were asked what he hoped to get from the excess of his sales over his purchases, he was apt to answer, money. Thereby he delivered himself bound into the hands of the economist, who fulminated that money is not wealth ; that money is a means not an end ; that the end is that which is received in exchange for money.

The mercantilist had no answer. His case broke down hopelessly under theoretical criticism. Yet perversely the practical statesmen continued to listen to him.

Mercantilism was in reality an empirical system. Its maxims were evolved from the experience of governments, which found trade to be the foundation of national strength. Its theoretical defence is to be sought therefore from the standpoint not of welfare but of national strength. Its real claim is to show how the resources of a country can best be made available for war

It may be criticized on the ground that this is not the right end to aim at. As to that there is much to be said, which we shall not say just yet. It is enough for the moment to recognize that the end is one which is in fact aimed at,

and which by many people, especially among those responsible for guiding national policy, is regarded as paramount.

On the other hand mercantilism may be criticized on the ground that it does not prescribe the best means for the attainment of its end. The classical economists agreed with the mercantilists that trade was advantageous. But they argued that it was only advantageous because it made possible economies of production or opened up new fields of production through division of labour. These results would be realized if trade were left free to take its natural course; production of each commodity would then be undertaken in the place and in the circumstances most favourable to it, and the products would be distributed by exchange in the places where they were needed.

The classical economists particularly found fault with the mercantilists' advocacy of exports. Trade would not take place unless it was advantageous to both parties, buyers and sellers. There was no presumption that it was more advantageous to the sellers. And even if it were, the idea of encouraging exports at the expense of imports was in itself fallacious. The foreign exchange market tended to equalize exports and imports, so that exports *could not* in the long run be encouraged at the expense of imports A fortuitous excess of exports might be paid for by an equivalent import of specie, but this was only possible to a very limited extent, and, if it did occur, was not advantageous. Superfluous specie was useless in itself; it brought no benefit till it was exported in exchange for something else.

These criticisms certainly contained much truth and force. But they did not cover the whole ground.

In the first place it is not true that the whole advantages of trade consist in the economies of production. As we have already pointed out, with a given volume of production, profits tend to become greater in the aggregate as the number of transactions and processes between producer and consumer increase. A part of the advantages of the division of labour is intercepted on the way from producer to consumer by the merchant. His profit is a toll levied on trade, and in the case of trade between distant places this toll is relatively heavier. Thereby the advantages to producers and consumers are diminished, and the volume of trade is presumably somewhat reduced, as compared with what it would be if ready-made marketing facilities came into being spontaneously, and producers sold freely without trouble or friction to the consumers who needed their products.

Thus when any branch of international trade starts, the question which most interests those who are directing economic policy is, where are the profits to go? Here is the explanation of the insatiable pursuit of markets which is characteristic of the governments of commercial states. The reward that Venice or Genoa asked from the early Crusaders was a merchants' quarter in Acre or Tyre, a street in which their own people might live under the jurisdiction of their own consul, with all the requisite quays and warehouses close by They also sought privileges in legal proceedings and freedom from various imposts and duties. With these advantages they could get the trade into their own hands and the profit would be theirs. With the conquest of Constantinople in the Fourth Crusade a fresh crop of similar privileges was secured. Then, it is true, Venice acquired the actual sovereignty of several important islands and provinces. But she frequently showed herself ready to give up the sovereignty, provided the new rulers were friendly and would guarantee her suitable commercial privileges and facilities.

All through the Middle Ages the right to trade in an interpost is regarded as a very valuable privilege, by no means to be had for the asking. The wisest governments accorded the privilege to a number of competitors, but, however many they were, their position was invariably regulated by agreement and concession.

In the period of ocean-borne commerce we still find the same system sometimes in operation. The Portuguese, Dutch, English and French acquired their "factories" (or commercial settlements) in the principal Indian ports But by that time that was no longer the rule. In the New World markets were secured by the more drastic methods of conquest and colonization. Commercial concessions depended upon agreements, and agreements might always be terminated by war between the parties. By the Treaty of Utrecht in 1713 England at last made a breach, though a small one, in the Spanish monopoly of the South American trade. The English merchants were allowed to send one ship a year. But the privilege did not survive the next war with Spain, which broke out in 1739. Even the Indian factories did not satisfy the ambitions of the great trading companies by which they had been established. The companies had from the beginning found it necessary to arm their expeditions, and their resources were soon so great that they were able to maintain armies and navies worthy of sovereign states (an instructive illustration of the potency of profits for the

purposes of war). Their settlements spread out into conquests, and in course of time the whole of India was subjected to their rule. In the process the balance of power among the companies themselves had been completely upset. English sea power had proved a decisive factor, and the English East India Company became practically the sole ruler of India. Among their competitors only the Dutch had anything more than a few isolated seaport settlements, and their possessions were confined to the great islands.

This is perhaps the most amazing example of mercantilist expansion that the world has ever seen. In the New World the case was quite different. The mercantile nations of Europe saw there two continents that were economically undeveloped and almost unpeopled. These continents in their then state did not constitute markets. Before they were worth trading with they had to be settled, and therefore they were valued in the first instance as colonizing ground A colony, once established in a region with natural resources, would become a particularly valuable market to the mother country, because the position of the merchants of the latter would be secured by the common sovereignty. The indigenous inhabitants were few and primitive, and quite incapable of disputing this sovereignty against the colonists as soon as the pioneer work had been completed and a community on the European model established.

But India was a continent almost as large and populous as Europe. It was an ancient and highly developed civilization. The European merchants sought, not vacant territory to be colonized and developed, but the opportunity of trading with the people who had been from time immemorial in full intensive occupation of the country. The East India Company, in order to safeguard their right of buying Oriental products and selling British manufactures, were actually led on, by the time-honoured methods of coercion and conquest, to arrogate to themselves the tremendous authority of a sovereign state over their customers. That was the only way by which they could be sure that their privileges would be preserved, and that their "goodwill" would not be encroached upon by competitors of other nations.

It is one of the paradoxes of history that whereas in the East, where the mercantile nations were content with concessions, they drifted into conquest and sovereignty, in the West, where they claimed sovereignty from the beginning, their colonies for the most part became independent. The colonies were founded to serve as markets, and the mother

countries proceeded to exploit them in accordance with the mercantilist doctrine. The policy, as Adam Smith said, was worthy of a "nation of shopkeepers," and it aroused intense resentment in the colonists, as soon as they became sufficiently numerous and organized to contemplate an independent commercial policy as a possibility. After the Seven Years' War the movement towards independence began in the British Colonies of North America. Early in the 19th century the Spanish and Portuguese Colonies followed suit, and the old monopolies were a thing of the past.

The 19th century saw a renewed competition for the political control of markets. In the East the Treaty Ports of China recall the early Indian factories. Australia and New Zealand offered an open field for colonization, at a time when England was in a position to exclude all rivals But the field for political mercantilism was in Africa.

Conditions in Africa differed from those in India in that (except in the North) it was not already developed by a settled and civilized population. They differed from conditions in America in that (except in the South) it was not fitted by climate for colonization from Europe. Far the greater part of the continent was peopled by primitive and in some cases savage races, who had hardly touched its great natural resources. The regions of this character presented a problem in the development of markets, to which the nearest parallel is perhaps to be found in the settlement of South America in the earlier period when the greater part of the labour was supplied by the native Indians. The dangers are obvious. The traders who settle in the country to exploit its resources are tempted to enslave the inhabitants, or, if avowed slavery is prevented by political considerations, to resort to every kind of expedient for enforcing labour.

The settlement of tropical Africa differs materially from that of South America in that it was entered upon after the effects of the industrial revolution had appeared in the methods both of production and of transport. Before the South American colonies of Spain and Portugal could function as markets, they had to be constituted as in essential respects self-supporting communities. A state of perpetual dependence upon regular supplies from Europe would have been impossible. Trade between the colony and the mother country was necessarily confined to those commodities which were of sufficient value in proportion to their bulk to stand the cost of the long sea voyage. Spain and Portugal were

not great manufacturing countries even according to 17th-century standards, and development was therefore slow. "Trade" consisted mainly in the payment of tribute by the Colonies to their mother countries, and much of the tribute was paid in gold and silver from the Mexican and South American mines.

Conditions in the 19th and 20th centuries have been very different. A country which has acquired rights over any new undeveloped territory will start by providing funds for a substantial capital outlay on means of communication. The labour engaged in this capital outlay can be supported out of imported goods, paid for by the credits received in the investing country, even if the new territory is as yet incapable of furnishing any exports at all. When the first stages of development are completed, the resources of the new territory can be applied to the production of the most profitable staples of which they are capable, and the commodities required for the consumption of the population can continue to be imported.

The result is that the colonies so greedily seized in Africa by the principal European powers were valued not only as markets, but equally as openings for profitable investment and as sources of supply of valuable materials. Besides the increased profits arising from the elaboration of the division of labour, there was an economic rent to be derived from the local advantages of the territory to be developed. We saw in Chapter IX how economic rent materializes when land is first opened up by new lines of communication. It is really this economic rent that makes the field for investment specially attractive. The effect of the development of any particular colony in extending the field of investment, merely stimulates the demand for capital and raises the market rate of interest. These tendencies do not interest the prospectors or the country under whose sovereignty they work; they cannot themselves expect to obtain any advantage from them. They are people in touch with the capital market and able, within limits, to direct a part of its resources whither they will. They use their knowledge to obtain concessions in the new country. In seeking the concessions they have to face no competition except from others like themselves, who have access to large capital resources. That competition is limited. The concession once acquired, money is raised for development by successive issues in the capital market. As the development proceeds, the economic rent accrues in the form of actual revenues which can be capitalized in the market issues. In the end

a great part of what appears in the balance sheet as the capital of the enterprise really represents sums paid to the promoters.

A new source of production of materials is valued as facilitating the industries in which the materials are used The trade which mercantilism seeks to encourage includes two distinct branches. The merchants of a country may exchange its own products for commodities for its own consumption, or they may act as intermediaries in exchanges between one foreign country and another. In the Middle Ages it was more especially the latter form of trade that was aimed at. Only a small proportion of the products of any area were exported, and outside the interposts themselves trade interests were of secondary importance. It was only when the products were gathered together at the interpost that statesmen began to feel an interest in them. For though the resources of a trading city were not great relatively to those of the regions from which they were collected, they had the inestimable advantage of being *liquid*, they were available for any purpose to which their possessors chose to divert them.

In modern times the circumstances have changed. One effect of the growth of great national states is that any important interpost is usually comprised within the boundaries of an extensive and populous state the products of which form a large part of its trade. It was pointed out in Chapter IX that manufacturing industry tends to be concentrated in the neighbourhood of interposts. The result is that in the pursuit of markets the interests of the manufacturers claim consideration. One of those interests is the acquisition of adequate and assured supplies of materials, and this has figured conspicuously in the exploitation of Africa.

It is not only in connexion with supplies of materials that manufacturing interests influence mercantile policy. The promotion of manufactures is itself a corollary of the mercantile theory and plays an important part in it. Manufacturing is a more stable source of wealth than pure commerce. Pure commerce depends mainly on communications and goodwill. Trade routes are liable to change, not only through developments in methods of transport, but through alterations in the economic and political circumstances of the countries which they connect. If a place which has become an interpost through its local advantages loses these advantages, its goodwill is not likely to save it for long. A merchant's goodwill is usually capable of a stubborn resistance when attacked, but the goodwill of a *place* is more vulnerable, for the

merchants themselves may migrate to a more convenient centre carrying their goodwill with them. But when an accretion of manufactures has attached itself to an interpost, migration is not so easy. The industrial plant once established, and the working people once settled in the neighbourhood, it is not possible to move them except at the cost of setting up new plant and providing new housing accommodation and other facilities. Even if all that were undertaken, it cannot be assumed that the workpeople could be induced to migrate.

But if, in the case supposed, the place remains a manufacturing centre, it must remain to some extent a commercial centre also. It must trade at any rate in its own products. Industry may be carried on under less advantageous conditions, and its profits may be diminished. There may not only be a decline in the producers' profits, but the capital sunk in industry may yield less than the market rate of interest, yet the commercial profit may continue with little diminution. For the sake of the industrial capital and the population attached to it, it will very likely be worth while to incur a heavy new capital outlay to maintain or restore artificially the advantages of communications which the interpost originally possessed.

Trade produces relations among economic communities analogous in one respect to those among electric charges. Like repels like, and unlike attracts unlike. Two countries with closely similar economic conditions become trade rivals ; with dissimilar economic conditions they would be one another's customers. The Imperialist expansion in which mercantilism expresses itself merely gives political form to these economic attractions and repulsions. The great industrial and commercial aggregations of population in Europe tend to attach to themselves extensive and sparsely inhabitated areas with varied climates and agricultural, pastoral, or mineral resources.

Such a policy presupposes an intimate relation between political sovereignty and commercial opportunities. In the next chapter we shall proceed to examine the nature and extent of the advantages that sovereignty over territorial possessions can bring.

CHAPTER XXIII

MERCANTILE IMPERIALISM

THE acquisition of distant territorial possessions is a form of Imperialism. It may be regarded from one point of view simply as a particular case of the tendency towards concentration of States. Concentration may so work as to consolidate into a single compact State a number of adjacent communities previously separate. Such was the formation of France in the 15th century or of Germany and Italy in the 19th. But it is not limited to such cases. A State which is surrounded by powerful and solidly founded neighbours, and is thus precluded from expanding into contiguous territory, may yet be able to increase its resources by seizing distant territory, where the inhabitants are not numerous enough, or are insufficiently organized and equipped, to make an effective resistance. But if that is all, the expansion is not of the mercantilist type.

On the other hand, whether the new possession is distant or contiguous, it may be specially coveted for its commercial advantages. A celebrated example is the low-lying country which surrounds the mouths of the Rhine and the Scheldt. In the Middle Ages trade and civilization spread northwards in Europe from the Mediterranean cities. The great rivers were far the best means of long-distance transport, and the Rhine was pre-eminent among them. The region in which this great waterway came in contact not only with the sea but with the economic system of Northern France was bound to be the seat of great interposts.

For century after century French ambition aimed at the acquisition of the wealth of Flanders. In the 14th century this ambition encountered the economic interests of the English, who depended upon the Flemish manufacturers as the purchasers of their wool, and who strove to keep this essential market out of the hands of the formidable and jealous French monarchy, and in its semi-independent attachment to the Dukes of Burgundy. This policy was followed with

consistent success[1] till the Duchy of Burgundy became merged in the still more formidable and jealous power of Spain. English policy then veered round to the support of the rebellion and finally of the independence of the Protestant Netherlands. But independence only solved half the problem

With the military and commercial decadence of Spain, French ambition again became the principal danger. To keep Flanders and Brabant out of the hands of France they were assigned first to Austria, then to Holland, and finally they were constituted into the independent kingdom of Belgium with an international guarantee of neutrality.

The infringement of this settlement by Germany in 1914 was dictated rather by strategic than by economic motives. The mercantile centre of the Low Countries is in Holland, for Holland contains the mouth of the Rhine, with its great port of Rotterdam, and the associated financial centre of Amsterdam. Belgium, notwithstanding the great trade of Antwerp, is yet predominantly a manufacturing rather than a commercial country.

Many other examples of much coveted interposts might be given. Some of those which formed the subject of mediæval struggles we have already noticed.

Constantinople has been fought for as much on strategical as on economic grounds. Since it has been in the hands of the Turks it has never possessed anything like the wealth or the commercial importance that might naturally be expected from its geographical position. The merchants who draw profit from its trade prefer for the most part to be domiciled elsewhere. The trade itself is far less than it would be if the adjacent territories were economically developed

Among interposts which have gained political prominence in recent times may be mentioned Fiume, Salonika, Smyrna, Memel and Danzig.

But these are still only particular cases of the concentration of resources. The distinguishing feature is that the resources acquired are predominantly commercial, and are specially valued on that ground. The country that acquires an interpost gains a number of rich citizens whom it can tax, and whose resources are specially adapted to being made readily available for war whether by tax or by loan. It seizes resources which already exist; it does not seek to *change* the course of trade

[1] The success was consistent in that Flanders was kept out of the hands of France. That the French monarchy itself was conquered and then lost in the struggle is irrelevant to our present theme.

On the other hand when it is led into conquest for the acquisition of markets, a change in the course of trade is its principal aim. That policy presupposes that the conquering country will be better situated to develop its trade with the conquered markets than if they had remained independent.

How far is that so? The answer to that question must be dealt with under two separate heads. First the conquering state may secure advantages for its own people by definite legislative or administrative discrimination against foreigners in regard either to taxation or to their legal rights and obligations. Secondly, there may be advantages arising out of a common sovereignty, which do not take the form of any such definite discrimination.

With regard to the former class of advantages, one subject, that of protective and preferential tariffs, which discriminate according to the country of origin of the goods dealt in, is so complicated and so far-reaching that we shall devote a separate chapter to it.[1] Here we will only say that in modern times it has become much the most important form of discrimination.

In the Middle Ages discrimination applied not only to the goods but to the dealers themselves. Every merchant did business as a member of a privileged body. Sovereignty over an interpost carried with it as a matter of course the function of determining which associations of merchants should have this privilege and on what conditions. But its power of discriminating was not so extensive as appears at first sight. The very existence of an interpost depends upon its intercourse with other interposts. However closely its merchants may be hedged round with privileges designed to exclude or deter foreigners, they must at some stage deal with foreign traders. If these foreign traders are only admitted to the interpost under serious disabilities or burdens, they simply will not come there. The trade of the interpost will then be in the hands of its own merchants, but they will find themselves bargaining with the same foreign merchants at other interposts. Because they make their bargains at a place a stage nearer the consumer or the producer it does not necessarily follow that they will secure a larger share of the profit. To do that, they must in some degree supplant the goodwill of the foreign merchants. Their privileged position may help them to do this. But not necessarily. Their power in a conflict with their foreign rivals will depend upon a variety of factors. Any one of the commodities dealt in at an interpost will be collected from a number of pro-

[1] See Chapter XXV.

ducers, either directly or through subordinate interposts, and will be exported thence to other subordinate interposts for distribution to the consumers. There must be merchants who buy the commodity and merchants who sell it. The former must be in touch with the various sources of supply, and the latter with the centres of demand. There is nothing to prevent a merchant undertaking both functions, provided he can maintain the requisite local connexions.

If the merchants residing at the principal interposts are given the exclusive privilege of trading there, that will not of itself enable them to establish these local connexions. If they are favourably situated in certain respects, however, their privileges may give them a decisive advantage over their competitors.

In any locality where a large proportion of the supply of some commodity is bound, owing to the geographical conditions, to pass through the interpost, the privileged merchants, provided they act in concert, can refuse to allow any intermediary to come between them and the retailers of that commodity. They can exercise a similar power in relation to the producers of any commodity in a locality from which a large part of the output of that commodity can only be marketed through the interpost. So far as commodities so circumstanced are concerned, they can compel the retailers and the producers to do business with them, and can thus make use of their power to create the local connexions.

The extent of their power depends ultimately on the local advantages of the interpost. Its local advantages consist mainly in good communications, which make it a convenient place for concentrating the exportable surpluses from the surrounding districts, and for distributing the imports received in exchange. The pressure that the privileged merchants can put upon those with whom they deal is limited by the inconvenience to which the latter would be put if they had to do their marketing at other centres. The inconvenience may be so great that there is no practicable alternative at all. But that is exceptional. It should be clearly realized that the question is not entirely one of the route by which the goods travel ; it is quite as likely to be a question of the point on or near the route at which bargains are to be made, and at which the ultimate destination of the goods is to be decided. Grain exported from Odessa to the West must travel *via* Constantinople. But the merchants who deal in it are more likely to be found in London than in Constantinople.

Where no other convenient centre is to be found upon the route, there may be alternative routes involving no serious disadvantage. Nor is it even necessary in all cases for the place at which dealings are carried on to be physically situated upon the route by which the goods travel. The merchant's essential needs are to be able to communicate (either direct, or through intermediate dealers) with the producers of the commodity he deals in on the one hand and with the retailers on the other, to be able to ascertain the supplies obtainable from the producers and the requirements of the retailers, to be able to arrange for the transportation of the supplies from the producers to the retailers. Finally he must be able to provide for the accumulation of stocks somewhere *en route*, in order that he may regulate the flow in every channel from the producers and to the consumers. When the means of communication were slow and unreliable, it was almost essential for the merchant or his fully responsible agent to be in physical proximity to his goods. As the means of communication have been improved, it has become possible for him to receive all the necessary information and give all the necessary directions at a distance.

Thus an attempt to discriminate against foreign merchants at an interpost is not unlikely to lead to the diversion of part of its business elsewhere. And as the means of communication have developed, the probability of diversion has grown greater.

Even when the circumstances are such that foreign merchants cannot carry on their business without resorting to the interpost, except at the cost of prohibitive inconvenience, it is still difficult to enforce discrimination effectively. So many devices are available by which the foreign merchants can shelter themselves behind the identity of natives (not necessarily by fraudulent or illegal means), that evasion is likely to be common, if not general.

Where discrimination is successfully instituted and enforced, it is still not an unmixed blessing to the country which practises it. There is an antagonism of interest between the merchants on the one side and the producers and consumers whom they serve on the other. The privileges of the former are likely to diminish the facilities open to the latter. If the merchants are content merely to take the places of their foreign rivals, without seeking higher profits, and if they are in all respects as efficient and well placed and well equipped for doing business, then the producers and consumers will not suffer. But if that were

so, the merchants would probably never have sought their privileges at all. It is much more likely that they will use their advantages to the full, and partly at the expense of the producers and consumers.

Merchants, though they are favoured by governments, are not usually popular, and governments prefer that the support they give should not be too conspicuous. The producers and consumers, in so far as they are subjects of the same state, have as good a claim on the government And even apart from their interests, the position of the interpost itself will suffer from any obstruction upon commerce. Obstruction may arise not only from the greed of the privileged merchants, but possibly also from their inefficiency. They may be inferior in enterprise, in technical knowledge, in financial power or in other qualifications, to their foreign rivals, or the protection afforded by their privileges may tempt them to be less assiduous in the prosecution of their business.

Thus there may be a loss of trade to the interpost not only by diversion but by an actual shrinkage in the business of the localities it serves.

Discrimination is dictated by the view that there is an indelible barrier between the merchants of one nation and those of others. In reality however, an interpost is usually a very cosmopolitan place; foreign merchants who do business there are often led to settle there, and prolonged residence assimilates them to the nation to which they look for the protection of their interests. When his assimilation is still incomplete, or even has not begun, the alien merchant is already a contributor to the resources of the State, not only as a taxpayer but also as a potential lender, and as a transmitter of funds. The advantages of discriminating against him are not so obvious to the authorities of the State as to the native merchant. He may not be so whole-hearted a supporter of the State in time of need as the latter, but his support will be more willingly given if he is treated on a footing of equality than if he is subjected to disabilities.

For these reasons States which possess interposts usually make the most of them by admitting merchants of all nations to do business in them on equal terms. Nevertheless this formal equality is not inconsistent with the existence of very real advantages to those merchants who are subjects of the State that rules in the interpost.

In the first place, though the existing policy may be one of complete equality, that policy can at any time be changed. The foreign merchant who builds up a goodwill

is giving a hostage to the State. If the foreign merchants as a body are too successful, the jealousy of the native merchants is likely to press for some kind of discrimination. Foreign merchants will therefore be cautious in building up their business upon the assumption of perpetual freedom from discrimination.

Secondly even with a perfectly genuine policy of equality, there are likely to be circumstances which amount in effect to discrimination. For example it is an advantage to those who trade between any two communities that they should have a common language, a common legal system or a common currency. A common sovereignty does not necessarily imply such uniformities, but it tends to promote them in course of time. And even when administration and legislation are ostensibly quite impartial as between natives and foreigners, the interests of the former are likely in practice to be put first. In particular they are more likely to be listened to when they press for legislative action of any kind. The legislature may be generously ready to remedy the actual grievances of foreign traders, but when it comes to making constructive, or far-reaching proposals, the interference of a foreigner, however well meaning, is out of place. He will only secure concessions when he can undertake something beyond the capacity of native enterprise.

Thirdly, there is the risk of war. If the State to which an interpost belongs is involved in war, the merchants of the enemy country immediately become outcasts. Their stock-in-trade and other assets are seized,[1] their goodwill is, for the time being at any rate, annihilated. In the majority of cases the risk of a merchant carrying on business in a foreign country becoming an enemy is not one of a very high degree of probability. On the other hand the probability of the country being involved in some war or other is substantial; the merchant, if his own country is not a party to to the war, will then be in the position of a neutral. Neutral interests may escape injury. But, if the war is a serious one, that is not likely; they are almost certain to be threatened in various ways.

The neutral in war is under suspicion because he remains friendly with the enemy. His commercial operations are likely to be subjected to a certain amount of restrictions in order to prevent the enemy from deriving advantage from them. Such restrictions are often extremely futile, because

[1] The supposed safeguards of private property in time of war do not in practice prevent this.

they can only be applied within the jurisdiction of the belligerent which imposes them, and they are likely to be injurious to him as well as to the enemy. But there will be some cases in which they are effective, and there may be many where their results are doubtful or injurious, but where they are nevertheless adopted. Nor are restrictions on trading the only measures to be feared A nation at war insists on exercising control over everything within its jurisdiction. Property may be requisitioned, and though it should presumably be paid for, the trading operations of the owner are for the time being completely upset; he cannot fulfil his contracts; he misses opportunities; his goodwill is shaken.

The merchants of the belligerent power are exposed to the same risks, but their case is different. They will be expected to make sacrifices for their country wherever they may carry on business. Moreover the belligerent Government will take care to treat its own merchants as favourably as possible, because the resources they derive from their business will be made available, by tax or loan, for the war. The neutral's resources may be, at any rate partly, so available, but that is uncertain.

Thus in one way or another the risk of war acts as a deterrent upon the establishment of foreign merchants in an interpost. The extent of its deterrent effect depends very much on how fresh in the merchants' memory the effects of war may be. Before 1914 the trading world had nearly forgotten how business might be affected by a war of the first magnitude.

Another very material factor is the power of a foreign country to protect the interests of its merchants should it be placed in the position of a neutral. The subjects of the great powers do not hesitate to establish businesses in those countries which are weak enough to be overawed.

It would seem, from the foregoing discussion, that the results to be obtained from discrimination, actual or virtual, among merchants, though not altogether negligible, are not very important. We cannot complete our estimate of the advantages of the common sovereignty exercised over a country and its territorial possessions till we have considered the subject of protective tariffs (see below, Chapter XXV). In the remainder of this chapter we shall turn our attention to certain other motives which lead to the acquisition of territorial possessions. First we shall consider them as openings for investment and sources for the supply of natural products.

For this part of mercantile policy the powers of Govern-

ment count for much more, at any rate in a region where development is in active progress. It is of course especially a region in that position that offers a profitable field for investment, though it may be a fully developed country that offers supplies of materials

The greater part of the investment in a country in course of development is applied to the means of transport. Railways, canals, ports, roads, bridges are all public utilities in the planning, construction and working of which the Government and Legislature are almost bound to interfere. Even if it be the accepted policy that private enterprise is to be employed as far as possible, and is to be given as much freedom as possible, still the promoters must come to the Government for power to acquire the necessary land, and the Government in granting these powers cannot avoid choosing between alternative schemes.

The Government will decide where the railways and ports are to be, and its decisions will go far to determine what shape the development of the country is to take. Upon them will depend the position and character of the country's interposts, and the priority to be given in the programme of development to one part of its resources over another. The concessions granted for the exploitation of the country must be planned in close relation with its transport system. In an undeveloped country these concessions will also be granted by the Government or at any rate by its authority. Probably any pre-existing rights are of a primitive kind, or, if there are civilized inhabitants, *ex hypothesi* their civilization has not extended to the full exploitation of the natural advantages of the country in which they live. Rights vested in people who do not intend to exploit their land will be regarded as an obstruction to progress, and will be swept aside (possibly with the payment of pecuniary compensation).[1]

A Government which has the opportunity of directing the development of a new dependency through concessions and railway schemes, will almost certainly keep the whole business in the hands of its own people, in so far as they are competent to undertake it. The promoters who propose the railways and ask for concessions, the capitalists who raise the money, the contractors who carry out the necessary works, all will be drawn so far as possible from the ruling country. The interposts will be so placed and so planned as to suit its merchants ; the resources to be exploited will be those suited to the requirements of its manufacturers.

[1] Compensation would, of course, be assessed on the value of the property *undeveloped*, to the owner.

These advantages of sovereignty are in addition to those which have already been described in the case of the purely commercial interests, and which apply at least equally to the capitalists and concessionaires. Indeed, to them the risk of interruption and possible permanent forfeiture of their business is more serious than to the merchant. The merchant's goodwill, just because it is intangible, is difficult to destroy. If he has been buying or selling rubber or sewing-machines in one place, he is already well qualified to start doing the same thing elsewhere. If he has an international business, he has more than one *pied a terre*, and the reconstitution of his business through new channels is all the easier. The capitalist on the other hand cannot afford to be cut off from the fixed capital in which his resources are invested. If he is a neutral in a war in which the country containing his capital is involved, he probably will not suffer much. Its earning power may possibly be interrupted, but unless it is exposed to actual damage from warlike operations, it will return on the restoration of peace to its normal condition. But, if he becomes an enemy, his capital is very likely to be confiscated. And apart from the contingency of war, he is also exposed to the risk of serious loss from action on the part of the Government which, even if not in form discriminatory, is so in effect. For example, it is easy for a Government to reduce or even to extinguish the profits of a foreign-owned railway by a limitation of fares and freight charges.

With regard to the supplies of materials, the advantages of a common sovereignty fall under three heads.

In the first place there is direct discrimination by state action. A State which possesses supplies of materials upon which its neighbours depend can put on an export duty, or make the export of the materials subject to licence. These expedients are not very often resorted to, partly because they excite retaliation, and partly because they militate against the interests of the producers of the materials themselves.

Secondly, when manufacturers seek to acquire interests in the production of the materials they need, it is easier for them to get the requisite concessions under the sovereignty of their own government than under that of another.

In some industries " vertical combinations," uniting the control of the production of materials and of the successive manufacturing processes applied to them, are a great advantage. Occasionally this supplies a motive for the acquisition

of territory by countries in which such industries are influential.

Thirdly, the aim is sometimes independence of foreign supplies in time of war. An industry may suffer in time of war from a failure of supplies of a necessary material, either because the country from which the supplies ordinarily come has become an enemy, or because the enemy is in a position to interfere with importation from neutral sources. The former case only arises where a disproportionate amount of the supplies comes from one country. That condition is exceptional, and may involve an uncomfortable state of dependence even under normal peace conditions.

The fear of interference with supplies from neutral sources is partly based on a delusion. If a country can so secure its communications in time of war that it can import supplies from its own oversea dependencies, then it can import them equally well from neutrals. But that does not entirely dispose of the point. Markets in time of war are apt to be disorganized, and it may be necessary for a belligerent government to take into its own hands the entire business of marketing some commodity which is vital to it, either for military purposes, or for the economic life of the country.

To such measures it may be essential that there should be some source of supply to which the emergency legislation can be made directly applicable. Otherwise the Government will find itself buying from a combination of neutral producers who are free to push up the price to exorbitant levels. In war *time* is vital, and trade combinations which are too ephemeral to exercise much power, or even to be worth forming, in normal circumstances, may be able to levy blackmail at a decisive moment.

Up to this point we have been discussing the advantages which a country can derive from the exercise of sovereignty over a dependency, on the assumption that the population of the dependency is given. We must now take account of dependencies as an opening for colonization. We saw in Chapter IX how economic conditions tend to determine the distribution of population. The development of new countries implies a continuous immigration into them from the old. This would be so even if there were no natural increase in the old countries. Population is unevenly distributed relatively to the local advantages of the different countries. The development of the local advantages of the new countries offers a higher real remuneration of human

effort than can be obtained in the old, and so attracts immigrants from them.

The tendency has been accentuated by the fertility of the populations of the old countries. With few exceptions, they have been able to furnish a large annual contingent of emigrants, and yet to show a steady and substantial increase in their own numbers at home

It might be supposed that any country which cares about its own power would seek to discourage emigration in order to have as numerous a population as possible. But for a variety of reasons that is not so. If the natural growth of population in a country outstrips material progress, there results a deterioration in the standard of living. Not only does this produce discontent, but it may actually diminish the country's power, despite the increased numbers, by encroaching upon the disposable surplus of wealth.

The result is that governments are anxious to find an outlet for their surplus population. It will clearly be thought most desirable that this outlet should be found among the country's own dependencies. People can then migrate without any change of allegiance. To the emigrants themselves, imbued with the taboos of patriotism, this appears as a great advantage, and very many of them will be led to prefer such a destination for that reason. Nor are the benefits of retaining the same sovereignty purely sentimental. The emigrants will find on arrival the customs, institutions and language of their own country. Once a country with surplus population possesses a dependency suitable in climate and resources for settlement by its own people, there ought to be no difficulty in directing the stream of migration thither.

It is very remarkable how little the actual history of colonies corresponds to this ideal. Most of the great colonizing regions suitable for white men have become independent. The exceptions are practically confined to the British Empire. Even there the white men's countries, though they retain a common allegiance, enjoy almost unrestricted self-government, which includes the right to legislate for themselves in regard to immigration.

Far the greater part of European emigration, which has attained since the middle of the 19th century the proportions of a mighty folk-wandering, has been directed to the independent republics of North and South America, and particularly to the United States. New countries, as they begin to fill up, become less anxious to secure fresh settlers and more fastidious as to those who are permitted to come. Recently

measures for the restriction of immigration have become distinctly more prevalent. The motive of such measures is sometimes the fear that the high standard of living which a new country enjoys may be threatened by the influx of fresh supplies of labour; sometimes it is the desire to preserve the racial purity of the existing inhabitants. The recent immigration laws of the United States were inspired by both motives, but are mainly racial.

With the diminishing fertility of European nations, the consequences to them of measures restricting immigration in new countries will not be so considerable as they would have been a generation ago.

In the East, however, the question is acute. In India and China the density of the population is such as to produce a very low standard of living. A certain amount of relief could be obtained (as it has in Japan) by industrial and commercial development. But that can only come slowly, and there is a natural desire for outlets for emigration The pick of the new countries are already occupied by the white races, and they are irreconcilably opposed to the free admission of Oriental settlers, who cannot be assimilated or absorbed, and would probably give rise to insoluble race problems

CHAPTER XXIV

THE EXPORT OF CAPITAL

IN the last chapter we saw that the economic advantages to a country of gaining the sovereignty over new possessions are found especially in the investment market. The investment market is the keystone of the mercantilist arch. When a pool of liquid resources has been created, it is not possible to tap it by means of taxation to the full extent of its capacity. Compulsory levies of money, when they are raised above a certain proportion of the resources of the taxpayer, are resented and as far as possible evaded, and to meet the gigantic demands of modern war it is essential to supplement taxation by borrowing.

As we saw in Chapter XXI, it is a further advantage if this borrowing is not confined to the collection of the investible savings which might otherwise have been invested at home, but extends to the diversion of resources from abroad. Under modern conditions every investment market is a branch of the world investment market, the equalizing effect of which is felt in the terms on which capital is raised in all civilized countries. It is not merely that the savings accruing in some countries have to be made available to meet the excess capital needs of others, but that there is a perpetual shuffling or exchange of investments between different countries. Each investment market deals in a certain number of purely local issues, which are not known or at any rate not sought in other markets, but side by side with these local issues are the great international securities, which can be bought and sold in practically all investment markets. Between the purely local securities and those with a worldwide market there are intermediate types, which are dealt in in more than one investment market, but not in all.

It is only the wholly or partially international securities that are completely equalized by the working of the market. The purely local securities may exhibit wide inequalities of yield, depending upon the opportunities in the area served

by each separate investment market. But in any investment market the local issues and the international issues are brought into competition with one another, and it might be supposed either that the yield of all must ultimately be equalized, or alternatively that in those markets where the local issues are most profitable no international securities at all would be held.

In practice, however, such is the variety of investors' needs that this does not occur. However high the yield of local investments may be, the quality of marketability will be so valued by some investors that they will hold a certain quantity of international securities, even though the sacrifice of income is substantial. The equalizing tendency is indeed always at work. In a place where the physical yield to capital is high, unless the profitable openings are limited in scope, the securities issued by the bigger enterprises will soon become either partially or completely international. In other words an *export of capital* will occur from the places of low interest to those of high interest; the former will buy the securities of the latter and will pay for them, as already explained,[1] with goods.

To serve the purposes of a country at war, the investment market must be capable of being diverted from its normal function of supplying capital for production and transport to the provision of funds for Government loans for military operations. The country's first call is upon the savings of its own people, who may be assumed in general to be willing to hold the securities of their Government, and in particular to be ready to make an effort to assist the successful prosecution of the war. Foreign resources can be drawn upon either directly, by an issue of the Government's securities in foreign investment markets, or indirectly, by people selling international securities through the investment market to foreign purchasers, and investing the proceeds in the Government issues. Government issues abroad are at best limited, and the real power of the investment market is in the volume of savings continuously accruing, and in the accumulated holding of international securities. These two factors are closely related. The accruing volume of savings is fundamental. International securities are acquired out of the surplus savings available after local capital requirements have been met. Other things being equal, the greater the savings the greater the surplus. But other things may not be equal, and with a given supply of savings

[1] See Chapter XI, pp. 118–9.

the holding of international securities may vary widely. For one thing, it depends very much upon the attitude and the habits of the investors themselves. The investors may prefer to hold the securities of local enterprises, so that they may have personal knowledge both of the business and of the people who direct it. They can themselves estimate its prospects, and the greater the knowledge the less the risk. But against the advantage of special knowledge the investor must set the disadvantage that he cannot sell his investment at its full value except to someone else who possesses the same special knowledge.

In order that investors may be induced to hold international securities, they must be enabled to obtain information about them. It is the business of the dealers in the investment market to acquire and to supply this information. But it is only worth their while to do so in respect of securities in which there is likely to be a substantial volume of business. It is a case, so common in marketing, where a branch of trading cannot exist in a small scale, and needs an effort to get it started. For the biggest international securities, such as United States Steel shares or Canadian Pacifics, the requisite information is at everyone's disposal. But for the majority a certain amount of special knowledge is necessary on the part of the dealers. Individual investors sometimes possess such special knowledge, but more often they depend on the advice of the stock dealers. There is naturally a tendency for each investment market to specialize in a selection of international securities which for any reason suit the convenience of its own investors, and of which its dealers make a special study.

In a centre where there is a surplus of savings available for investment in foreign securities, it may happen that, for want of adequate information and of an organized market, very little of the surplus is so applied. The savings may be directed to a disproportionate extent to investment at home, and, as all the best openings are filled, the local rate of interest may be correspondingly lowered. To a borrowing Government the low rate of interest is of course a very substantial gain. But in time of war the vital necessity is not so much to borrow cheaply as to borrow *much*. What can be borrowed at home is limited to the current savings of the country. To secure a considerable proportion of these, a rate of interest must be offered high enough to compete with the more attractive industrial and commercial openings. A high rate of interest is equally required to give a temporary stimulus to saving by the offer of an exceptionally

favourable opportunity. Under pressure the Government would soon be paying as high a rate as would be necessary to induce people to sell international securities, if they had them, in order to lend to it. At that point the extent of international securities held becomes a matter of great importance. Those securities represent *past* savings. Past savings that have been put in local enterprises which are unknown to the international investment markets are irrevocably tied up ; past savings invested in international securities can be mobilized. That does not mean that the capital in which they have been sunk can be unravelled, any more than that of the local enterprises. But the international securities afford the means of drawing upon the current savings of the whole world

Governments are sufficiently alive to this advantage to desire to encourage the organization of the international side of the investment market. They have, however, but little power to do so. The organization of the market is in the hands of the stock dealers and the issuing houses and others concerned in capital flotations. These great men take little account of the desires of Governments. Government interference of any kind, if it has any effect at all, would probably lead them to move their operations elsewhere, and there is little that a Government can do, apart from leaving them free from interference, to attract them.

But when a Government is in a position to dispense favours in an undeveloped territory, it can offer something substantial. An undeveloped territory is essentially an importer of capital. To breed prosperity, it must be married to an exporter of capital, that is to say to one of those pools of accumulating profits in industrially developed surroundings in which an investment market grows up. Where there is a common sovereignty, the Government can help in consummating the happy union. It can float loans for its dependencies through its own capital market, and can sell concessions to its own capitalists. Capital issues of this kind conduce to the creation of an international investment market. As soon as a market is created in the securities, a demand is likely to spring up for them in foreign investment markets. When they are sold abroad, the proceeds will often be reinvested in other international securities, and the market for international securities will thus be widened. *L'appetit vient en mangeant ;* as investors get used to holding international securities, it will become worth while to make some securities, previously purely local in character, marketable abroad Such securities must, of

course, be important enough in themselves to sustain an international position, but they can only be given that position if dealers in foreign investment markets are made familiar with them, and enabled to obtain all the requisite information about them. In so far as the internationalization of the investment market takes this form, it does not diminish the funds available for investment at home. But on the whole internationalization is likely, in a country with surplus savings, to divert a certain amount of investment from local to foreign openings. The competition of lucrative foreign investments will raise the rate of interest, and enterprises at home will have to be satisfied with less capital.

The total yield of investments to the community will be increased by the substitution of more profitable foreign securities for less profitable domestic. But it cannot be taken for granted that this will promote the welfare of the community as a whole. If the capitalists had to put up with less profitable openings for investment at home, the consequent redundancy of capital would have various reactions upon economic conditions. The marginal rate of interest being lower, the yield of the pre-existing capital would be less. The additional capital would yield something to its owners, but this would be less than its value to the producers who use it. Thus the greater part of what the capitalists would lose through the fall in interest would accrue to other classes of the community. How it would be divided among the recipients of wages, economic rent and profit depends on circumstances, the analysis of which would present too complicated a problem to be followed out here.

By taking advantage of the profitable foreign investments the capitalists do probably increase the total national income as commonly reckoned in terms of wealth. But that is not the principal motive for encouraging foreign investment What is really sought is the development of an investment market through which the national resources can be readily mobilized. International investment dealings are also a source of profit. Issuing houses and underwriters both get their commissions on the issue of loans. Still greater are the profits on share flotations, especially if the promoters start by getting valuable concessions, which they can develop before the public issues of shares are made. Perhaps it is these profits that really play the largest part in moving Governments to acquire territory. It is the capitalists coveting lucrative concessions and splendid company promotions who urge and intrigue to get the politicians to move. But if they find the politicians not merely willing but eager to

comply, that is because high finance is regarded as the quintessential embodiment of national strength.

A field for foreign investment is also valued by those industrialists who are engaged in producing the commodities required for capital equipment. It is not every country that has the opportunity to establish production of this kind on any considerable scale. Capital equipment, at any rate such part of it as can be exported from one country to another, is mainly produced by various branches of the iron and steel and engineering trades. Those trades can only flourish at places within reach of supplies of coal and ore—especially coal. The line of coal-fields in North-Western Europe, extending from Lanarkshire to Westphalia is the seat of great iron and steel and engineering works, which depend for their activity upon the continued exploitation of the new countries of the world. That continued exploitation depends in turn upon the great investment markets of London, Paris, Amsterdam, Vienna and Berlin. The individual industrialist does not identify his interests with the working of these investment markets in general. His direct concern is with each separate project as it arises. He looks for orders for steel rails, locomotives, structural steel, mining or textile machinery, turbines or dynamos, and he believes he is more likely to get them if the capitalists who give the orders are his own countrymen. It might be supposed that the industrialist is mistaken in thinking that this will make any difference; if the capitalist is a reasonable person, will he not order his plant from the manufacturer who can supply it cheapest? But big engineering contracts are very different from purchases of boots or handkerchiefs or sewing machines, that can be supplied in indefinite quantities by the producer according to sample. The efficiency of the manufacturer has to be judged not by samples but by his reputation. In this, which must be the first consideration, the purchaser must be guided by his own knowledge, and he will have recourse to the manufacturer with whose personality and business he is himself acquainted.

There is a profound difference between the ordinary commodity markets and those for capital equipment. The former are atomically organized. They record the resultant effect of an indefinite number of separate volitions, each one of which is lost in the multitude. The volume of the stream of products is adjusted by infinitesimal gradations to the demand signalled by a legion of retailers.

For capital equipment a great part of the demand emanates from a limited number of consumers, each one of whom

gives orders on a large scale. Producer and consumer meet and bargain face to face. Production on a large scale is especially characteristic of the heavy industries. We saw in Chapter VIII how the tendency to concentration may threaten the existence of those producers who fail to take advantage of it. When extensive markets are a condition not merely of the prosperity of the producer, but of his survival, it is easy to understand that the competition for orders will be keen.

Manufacturers in the heavy industries are, like the capitalists, few in number and great in wealth. They are, therefore, well qualified to exercise influence over Governments and Parliaments. And their influence is increased by the close dependence upon them of the supply both of munitions and of the means of transport, the prime requisites for warfare.

An imaginary illustration will show the profits that can be derived from economic Imperialism. Suppose that a country has acquired a piece of undeveloped territory, and that deposits of copper have been discovered in the interior. The Government sets to work to get this source of wealth exploited. The first essential is a railway connecting the copper district with the coast or with the nearest communication centre. To raise capital for that, while the copper mining is no more than a potentiality, the Government must either offer direct support, with a guarantee of a loan or of a certain revenue, or it must find some promoter or group of promoters in the investment market, who have sufficient knowledge and confidence in the prospects to take the first step. The promoters will expect an ample inducement in the form of local concessions.

The money raised for the railway is paid to contractors, who spend it partly on rails, rolling stock, structural steel, etc., exported from the mother country, partly on labour locally employed. The rails and rolling stock of course bring the usual profits to their producers, not only to those who manufacture them, but also to those who produce the fuel and ore with which they are manufactured, and to those who ship them to their destination. The local labour must be housed, and possibly transported from other districts. The contractor will provide the housing, and will probably be given land for the purpose as part of the railway concession. Upon the whole business the contractor will receive the usual profit, included as margin in the capital floated for the railway. Very likely he will be interested in the issue and underwriting of this capital, and will receive commission in

both capacities upon it. The first use to be made of the railway will be to import the necessary labour and machinery to work the copper. For this capital funds must be supplied. That may be done through the formation of a copper-mining company and an issue of shares. But the ordinary shares, with unlimited dividends, and carrying control, will not be issued at this stage to the public. Either the promoters will start the whole enterprise out of their own capital, or, if they need to supplement their resources from the market, they will either borrow, or issue preference shares carrying a fairly high but limited dividend and not conferring control The promoters may include the capitalists interested in the railway, who rely upon the development of the copper mines for traffic, the contractors for the mining machinery, who will accept shares in part payment of their contracts, some firm of copper smelters who will be purchasers of the ore, together perhaps with ship owners, and land speculators. Their general characteristics are that they are people of substance, accumulated from past profits, and that they look to the enterprise on hand not only for direct profits, but for some support to their own businesses.

When everything is installed, the output of copper begins The direct cost of production of the ore consists of the expenditure upon labour on the spot. The difference between that cost and the price received for it when finally sold has first to cover freight (including that on the local railway) and costs of marketing, and then to supply the dividends to the people interested in the copper mines. But it would be a mistake to suppose that the whole sum spent in wages is really properly classed as cost of labour. The houses in which the workmen live will belong either to the copper mining company or to the railway company. Most of the commodities they consume will travel by the railway, paying their toll of profit on the way. Wages, in the circumstances, will probably be very high, but that is part of the necessary cost of the copper, and will have been allowed for in all the calculations from the beginning. If the copper could not be worked at a profit on those terms, it would have been left alone.

Finally when the whole business is well established, and the future yield of the shares can be estimated, the capitalists will dispose of a great part of their holdings, and use the capital in another lucrative promotion elsewhere.

From this imaginary example it will be seen how the opportunities of profit are multiplied at every stage of the process of exploitation. In proportion to the magnitude of

the profits is the urgency of the applications for concessions of all kinds, and further back is the pressure to acquire territory which must otherwise either remain wild and insecure to the exploiter or pass into the hands of rival States, who would use it to further their own economic interests.

Exploitation on these lines secures an export of capital at a low cost. A great part of the nominal amount of capital exported is really the profit pocketed by the exploiters, so that the real cost to them is something much less. This is particularly so at the final stage, when the enterprises are firmly established and shares capitalizing the future profits are issued in the market. These shares may represent a sum several times as great as the true capital outlay incurred. If the capital exported is measured by the market value of the securities which represent it, it greatly exceeds the amount by which investment at home is curtailed.

It must not be forgotten that there are many failures among the capital issues for the exploitation of new countries. But the losses fall for the most part not on the promoters but on the investors who buy the securities in the open market. The promoters make use of their special knowledge to keep the certainties in their own hands, and to sell the risks at the earliest opportunity. To the investors the affair is often a gamble. Choosing without adequate knowledge, they trust to chance for success. If cases of fraudulent promotion be set on one side, it is probable that among the honest enterprises the losses to the investors are not more than a moderate set-off against the gains. But even where there are losses, there may yet have been large profits to some at any rate of the promoters.

The export of capital is a great source of strength, even apart from the development of an international investment market, and from the opportunities which it offers for promoters' profits. When a country is a regular exporter of capital its exports and imports of commodities must be so adjusted as to provide a continuous export surplus equal to the net capital exported. Price levels and foreign exchanges must be in equilibrium under those conditions.

When the time comes for the country to mobilize its resources, the surplus savings ordinarily invested abroad are diverted by tax or loan into the hands of the Government. At the same time the country's productive resources are no longer available to the same extent as before for export. But, in so far as exports have formerly represented exports

of capital, they can be cut short without any corresponding diminution of imports.

In the export of capital we find the solution of that excess of exports which is dear to the heart of the mercantilist, and the possibility of which the classical economist was inclined to challenge. In the early days of the mercantilist doctrine the idea of the export of capital had hardly emerged into the light. The mercantilist felt in his bones that it was a good thing to export, and to acquire credits abroad, which the country should not dissipate in the acquisition of imports but should hold. Yet he could not imagine any form in which those credits could be embodied except specie. The export of capital, however, was by no means unknown in the days before organized investment markets existed. The rich merchant of the Middle Ages became the owner of a good deal of wealth outside his own city. He might possess houses, warehouses, and other property in the places with which he carried on business, he might possess ships and stocks of commodities, and finally he might be the creditor of distant customers. The stocks of commodities, it is true, yielded no interest, nor ordinarily did the debts (though various devices were resorted to for exacting interest without incurring the penalties against usury), and the mercantilist regarded such possessions merely as stages on the way to the acquisition of specie.

It was only with the invention in the 17th century of investment dealing through the instrumentality of inscribed stocks and paper securities that it became possible for a nation to become an exporter of capital on a grand scale. It is noteworthy that these dealings began with national debts at a time when investments in industry and transport were still on a modest scale.

In the 18th century the pre-eminence in this respect belonged to Holland, Amsterdam was the financial centre of European trade, and its position was freely used in the wars against France. London was in the first instance financially a satellite of Amsterdam, and even in Adam Smith's time, when the military alliances of the two countries were a thing of the past, a great part of the English national debt was still held in Holland. But before then, in the Seven Years' War, England had begun to use the power that wealth gives. Her needy allies, however, could not even make the pretence of promising repayment, and the help they received was in the form of subsidies. In the Napoleonic Wars the same system was continued and extended, though at one time it was varied to the extent of issuing loans for

the Holy Roman Empire in London with a British guarantee —not a very fortunate experiment as it turned out.

Soon after 1815 the internationalization of the investment markets began to make rapid progress. English investors burnt their fingers rather severely with loans to rickety foreign Governments in South America and elsewhere. But when railway development began, the growing accumulations of industrial and mercantile profits found an outlet, which had the merit of being economic rather than political.

British foreign investment seems to serve equally well as an illustration of the advantages of territorial possessions for investment and of the possibility of investing on a prodigious scale in countries that remain foreign. Of the £4,000 millions at which the total external investments of the country were estimated in 1914, more than half was in foreign countries, especially in the United States and Argentina and other South American republics. On the other hand, the share of the British Empire was *relatively* greater, if reckoned in proportion to the total capital needs of the borrowing countries.

The preference arising from a common sovereignty is illustrated by the Colonial Stock Acts, which make the national debts of the Dominions and other British Possessions trustee investments in the United Kingdom on certain conditions. It is not merely that an additional demand for the stocks on the part of trustees is created by these Acts, but the security for all British investors in them is improved, owing to the provisions expressly recognizing the sovereign right of disallowance (on the advice of British Ministers) of any legislation impairing the security.

The very favourable terms on which the Dominions and other British Possessions borrow in London are by no means wholly or even mainly traceable to the Colonial Stock Acts Municipalities in the Dominions can borrow cheaply in London, although their issues are not trustee investments. Floods of British capital are poured out for enterprises of all kinds.

The tremendous financial strength of Great Britain was an outstanding feature of the Great War. So great were her accumulations of foreign investments that the annual sum derived from interest, dividends and profits upon them exceeded the annual amount of fresh investment abroad, and there was regularly a large excess of imports.[1] The

[1] The excess was of course due in great part to other huge invisible exports, such as shipping freights, and financial and mercantile profits.

mere suspension of investment abroad was enough to add £150,000,000 or £200,000,000 to the import excess without any countervailing liability being placed upon the country at all. In addition hundreds of millions were sold out of the country's holdings of foreign securities (especially American securities collected by the Government and sold to American investors).

Second only to Great Britain among exporters of capital was France. France was in several respects peculiar. In the first place her supplies of investible capital were not derived to anything like the same extent from commercial and industrial profits, as those of England, Germany, America, Holland or Switzerland. Such profits in France were no doubt substantial, but they were rivalled by the accumulations of innumerable thrifty farmers and peasants, and the investment market laid itself out to suit this special class of investors. The big banks with numerous branches acted as agents of the investment market in disposing of securities to their millions of customers. The favourites were not industrials, or even commercially owned railways, but Government bonds. Unfortunately for the investor, he was exploited for political ends ; he was induced to buy the bonds of his country's ally, Russia, in disproportionate quantities. For a class of people whose motive was to lay by for the future, the lending of money to a reactionary and corrupt autocracy whose history was being visibly written in terms of war and revolution seems to be a curious choice. But if we regard mercantilism, like diplomacy, as virtual war, the system becomes more intelligible. Instead of leaving the investor to choose sound international securities, which could be realized in time of war, he was induced to hand over his money directly to pay for the construction of railways and munitions for an allied country by way of preparation. The investor lost his money because, when the war came, the ally could not stand the strain. The strategic railways were not finished, the munitions were inadequate, the Government was inefficient and corrupt.

Still the investment was not wholly fruitless. Russia at any rate kept sixty German divisions occupied for three years. And the investors might have chosen apparently much sounder investments (e.g., German or Austro-Hungarian) with no better pecuniary result. Even their own sacred French Rentes have been reduced to a fraction of their former value by the depreciation of the currency.

The question of the export of capital has acquired interest in a new direction since the War The War has left behind

vast international liabilities in the form both of debts from ally to ally and of reparations from the vanquished to the victor. Mercantilist critics, when they realized that these liabilities would have to be paid, if at all, in the form of goods, did not hesitate to uphold the paradoxical view that such a transaction was a greater benefit to the debtor-exporter than to the creditor-importer. To any such contention it is not difficult to find the answer. The imports come in response to the additional spending power of the people in the creditor country. Their consumption being increased by that amount, the market for other goods (including their own products) is not impaired. In fact the country is placed in the same position as if it were receiving interest upon foreign investments laboriously accumulated, in other words, as if it were reaping the fruits of a long-continued excess of exports.

Nevertheless there is an element of truth in the paradox, which might in certain circumstances deserve attention. A country compelled to meet a new external liability is driven to increase its exports and to diminish its imports. This might be accomplished easily and with little friction. The Government (if we suppose a Government liability to be in question) raises the requisite sum by taxation, and the taxpayers must reduce consumption by that amount. The falling off in demand is felt in the various markets. In so far as it is felt in the markets for foreign trade commodities, the result is to diminish the demand for imports and to set free additional exports ; to that extent the problem is solved. But in so far as the falling off in demand applies to home trade commodities, it has no direct effect on the balance of trade ; it merely produces a slackening of demand in these markets. To complete the necessary adjustment and secure an adequate relative increase of exports, what is really required is to divert a portion of the productive power of the country from home trade products to foreign trade products. The diversion may be a difficult and painful process,[1] but, once it is completed, the effect is to increase the exporting power of the country and to diminish its dependence upon imports. Apart from any physical change in the country's productive capacity in these directions, the result will be secured by a fall in the level of remuneration in the country as expressed in terms of foreign currencies; and therefore in terms of world prices. The fall may take

[1] It depends *inter alia* upon the management of the foreign exchanges and the control of credit. See "Currency and Credit," 2nd edition, pp. 399/409.

the form either of a general lowering of money wages and of the prices of home trade products, or of an adverse movement of the foreign exchanges, which raises the prices of foreign trade commodities and leaves other money values unaltered.

There will thus be a lowering of the cost of production in the debtor country, and its competition in the particular industries in which it is qualified to export will be intensified. Competing countries in these industries will suffer. But the creditor countries *as such* will not suffer. If they do, it will only be because they chance to contain some of the industries affected.

A country, which becomes entitled to receive payments from another, has to undergo changes just the reverse of those which occur in the debtor. There is an increase in effective demand, which partly affects the markets for foreign trade products and partly those for home trade products. To the extent that it affects the former, it increases imports and diminishes exports. But, to the extent that the demand is met by home trade products, the balance of trade is unaffected. To achieve equilibrium some of its productive activity must be diverted from the foreign trade products to the home trade products. The increased importations of the creditor countries will balance the increased exportations of the debtor countries. If in world markets as a whole some industries are depressed, others will be stimulated.

If the international payments continue for a period of years and then suddenly stop, there must be a new readjustment. The former debtor country will have more exporting power than its circumstances require; the former creditor will have less. They would have to regain equilibrium by reversal in each case of the previous process of adjustment.

But in practice that is not what would happen. The creditor country would more probably save out of its superfluity and a great part of the sums to which it was entitled would be accumulated in the form of foreign investments. The debtor country would not make all its payments in the form of additional exports or diminished imports, but would cover a part by borrowing abroad or by diminishing the foreign investments that it would otherwise have been in a position to hold. The result would be to diminish the effect of the payments during the period when they are actually falling due, but to leave behind liabilities on the part of the debtor and assets in the hands of the creditor involving an

indefinite continuance of interest payments. There will then be no abrupt change.

One other aspect of the export of capital requires to be mentioned. It may take the form of short-term lending by banks. Where capitalists in one country establish a bank in another, the export of capital is not of this kind, for though the bank lends in the country in which it is situated it also receives deposits there. From the point of view of the proprietors the bank is a permanent investment. Short-term lending itself constitutes an export of capital only when the country in which the money is lent is different from that in which the liabilities of the lending bank are payable. There are many ways in which this may come about. A bank with head office in one country and a branch in another may receive deposits in both and make advances in both, and in one or other the advances may exceed the deposits. But the most characteristic instrument of international banking is the bill of exchange. A great international discount market, which buys bills drawn to finance a great variety of commercial transactions arising in other countries is an exporter of capital. It is the practice for traders in many parts of the world to arrange for their purchases of goods to be financed with bills payable not in their own countries, but in London, and made out in sterling, so that the bills may be sold in the London money market. Some of the merchant bankers in London, known as accepting houses, specialize in the business of acting for such traders. The seller of the goods which one of these traders buys is authorized to draw a bill not on the trader himself but on an accepting house. When the bill matures, the accepting house has to pay it, but the trader undertakes to provide the necessary funds in time.

Such a bill, payable in London and backed by the credit of a well-established London firm, can be readily sold in the money market. The accepting house's debt to the holder of the bill is an internal affair, it is an obligation of one London concern to another. But the creation of the trader's debt to the accepting house is an export of capital. Such debts are a great source of financial strength to London. If England requires to raise money abroad in an emergency, all that is necessary is to slow down the accepting of bills on behalf of foreign traders. As the outstanding amount of such bills diminishes, the obligations of the traders on whose behalf they were drawn have to be paid up in cash.

In the exceptional circumstances of 1914 the system broke

down, because the strain of immediate remittances was more than the foreign exchange market could stand. Under more normal conditions it works easily and surely. The slowing down of accepting business is brought about by raising the rate of discount, which makes borrowing from London less attractive to the foreign trader

CHAPTER XXV

PROTECTIVE TARIFFS

In treating of the methods by which one State can discriminate against another in the territory under its jurisdiction, we postponed consideration of the most important of all, protective tariffs. Here we find one of the historic battle-grounds of economics. As we travel from argument to argument, from thesis to thesis, we are reminded at every step of the great protagonists of the past, of Adam Smith and Ricardo, Mill and Marshall, Cobden and Bright, Peel and Gladstone, Alexander Hamilton, List, Bismarck, Méline, Chamberlain. How difficult it is to see clearly amid the dust and heat of age-long conflict!

We must try to forget controversy, and to see the subject objectively and impartially. Let us remember that in all controversies which have any life in them there is always something to be said on both sides. Whichever side we take, we shall be none the worse for appreciating the arguments of the other, and giving them due weight.

In this particular controvery, which has for so long been contaminated with politics, many of the most cherished arguments on both sides are more or less fallacious. That facilitates impartial consideration, though bias may pervert new arguments as well as old.

A duty on importation of a commodity is *protective*, if the commodity is produced within the area to which the duty applies, and when so produced is not subject to any duty.[1] It discriminates between the home producer, who pays no duty, and the foreign producer, whose product cannot reach market without paying the duty *en route*. Protection is recommended on three grounds: that it stimulates production and employment at home; that it extracts money by way of taxation from foreign producers; and that it promotes

[1] If there is an excise duty on home production, but materially lower than the import duty, the excess of the import duty over the excise duty is protective.

an excess of exports over imports. Against it the classical economists argued that it could neither promote an excess of exports nor stimulate production as a whole; imports and exports must balance, and if some industries are stimulated through a restriction of imports, there must be an equal diminution of exports by which other industries will be injured. As to the taxing of the foreign producer, they pointed out that the price of the dutiable commodity within the protected country must exceed the world price by the amount of the duty, and therefore the consumer pays; he pays the duty that the Government receives on the imported part of the supplies, and in addition pays an extra profit to the producer of the remainder at home. On broader grounds they contended that productive power tends in a free market to flow into those channels where it is most effective, and that any artificial interference with its freedom will on the whole involve a loss, even if some of the people or communities concerned may secure a gain.

Rather than follow out the answers to these criticisms and the rejoinders and refutations which have been heaped up in the course of a century and a half of controversy, it will be better to investigate systematically what the effects of protective duties are likely to be, and especially to trace the varieties of effects arising under different conditions.

In the first place we must distinguish between the *transitory* effects of the imposition or increase of a protective tariff and the *permanent* effects of the maintenance of such a tariff for an indefinite period unchanged.

Suppose a tariff newly imposed. Dealers in the commodities affected will offer the same price for the duty-paid foreign supply and for the duty-free home supply. If the home and foreign producers were before making normal profits, the profits of the latter, being diminished by the amount of the duty, will become less than normal, and may be turned into a loss. The market will become less attractive to the foreign producer, who will probably diminish his output, and try to sell more elsewhere. There will thus be a diminution of supplies in the protected market, and probably a rise of prices. Cases may easily be supposed in which, at that stage at any rate, there would be no rise of price. At the moment when the tariff comes into operation the home producers of some protected commodity may be working at less than their full capacity. When foreign competitors are driven out of the field, the first effect may then be simply to increase production up to capacity. It may be more profitable to maintain output by selling at as low a price

as before than to charge a higher price and continue producing below capacity.

Even when the home producers are working up to capacity, the same result may yet occur through an extension of plant, by which the home producers gain the advantages of large-scale production and reduce costs This however, should be considered as part not of the transitory but of the permanent effects of the protective tariff.

Whatever the immediate effects of the tariff may be on the prices of particular commodities, there will be a curtailment of imports and a disturbance of the balance of trade. The deficiency of imports will react upon the exchange market. The value of the country's currency unit in terms of other currencies will rise. If its own currency and the others are fixed in terms of gold, the exchange cannot rise above the gold import point. Gold will be imported. This will favour an expansion of credit. In fact the import of gold will continue till a sufficient expansion occurs, and eventually equilibrium will be restored with a higher general price level.

This rise in the price level is quite distinct from the *relative* rise in the prices of protected commodities. It is a consequence of the disturbance of the balance of trade, and must be sufficient to correct that disturbance. If at the outset none of the protected commodities rose in price at all, the disturbance would be all the greater. The rise cannot extend to exportable commodities, which continue to compete in world markets, but will take effect in importable commodities, so far as they are protected, in home trade commodities, and in the price of labour. Producers of exportable commodities will find their costs of production rising, and, when the transitional period is completed, will find themselves in an unfavourable position. At the beginning of the transitional period, however, even the export industries will be prosperous; they will participate in the general stimulation of demand occasioned by the expansion of credit before the rise of prices and of costs has taken effect. A feature making for the popularity of a protective tariff under a gold standard regime is that it enables a country, during the process of adjustment after it is imposed or increased, to enjoy the forbidden pleasures of monetary inflation, without paying the penalty of a depreciation of its currency in the foreign exchange market.

On the other hand, when the country adopting the tariff has a monetary standard independent of those of its neighbours, the effect of the check to imports is not to bring about

an influx of gold and an expansion of credit, but to start a favourable movement of the foreign exchanges. The country's currency appreciates relatively to other currencies, exports are checked and imports stimulated, and the balance of trade is restored without any change in the average level of prices. Exports, being at world prices, are cheaper in terms of the country's currency. So are any imports which are not dutiable, and dutiable imports in bond (i.e., prior to payment of duty). Duty-paid imports are dearer. Labour and home trade commodities are substantially unchanged. Under these conditions exporters have to face an immediate fall in prices, without any compensating temporary increase in the home demand. Protection in such a case effects an appreciation of the currency in the foreign exchange market without involving any contraction of credit or deflationary measures.

Next we turn to the permanent consequences of a tariff. First we may distinguish the effects upon different types of industry. Apart from the machinations of trade combinations, which may take advantage of a tariff to sell dear at home and cheap abroad, the tariff will have no effect except on a commodity part of the supplies of which come (or would otherwise come) from abroad.

Take the case of a natural product, agricultural or mineral. Here the tendency is for the commodity to be produced from all land where the local advantages are such that the world price is expected to yield at least the normal profit over cost of production. If there is an import duty, imported supplies can only be sold at a price exceeding the world price by the amount of the duty. The result will be that land will be brought under cultivation where the local advantages are such that the cost of production, though too high to leave a normal profit out of the world price, will yet leave a normal profit out of a price exceeding the world price by the duty. If the land of this class within the protected area is more than sufficient to provide the whole supply of the commodity, (the demand for which will presumably be diminished by the rise of price), only a part of such land will be brought under cultivation, and the imported supply will entirely cease. The home price will then exceed the world price by something less than the duty. If the land is insufficient to provide the whole supply, some imports will continue. The difference in price will then (except for local variations) be equal to the duty.

The extent to which home production can be substituted for foreign production depends on the amount of land on

the margin. In a country which is both an exporter and an importer of agricultural products a protective tariff may divert a large quantity of land from one form of production to another. There the power of the tariff depends mainly on the relative natural advantages of the land for the different kinds of production In the much commoner case where the country adopting agricultural protection is on balance an importer of agricultural products, an increase in the production of the protected commodities will necessitate bringing new land under cultivation. In such a country, however, where *ex hypothesi* all the land that the unassisted advantages of proximity to the market could bring under cultivation is insufficient to meet the demand, it is unlikely that there will be a very large quantity of marginal land to draw upon. This is conspicuously so in the densely peopled industrial countries of Europe, where a heavy increase in price procures a very moderate extension of cultivation. Nor is the case substantially altered by the fact that the rise of price elicits a certain amount of intensive cultivation. Owing to the law of diminishing returns this resource is apt to be as limited as the extension of area.

Manufactured commodities differ materially from agricultural products in their reactions to a protective tariff. Local advantages matter less to them, and a slighter inducement is required to move them from one place to another. The circumstances vary widely. Those manufacturing industries which are attracted to a particular district, to minimize the transport costs of some heavy material, such as coal, may be almost as difficult to shift as agricultural or mining industries themselves. Other industries have been attracted to a particular spot by some quite trifling convenience or saving of cost. A country that imports the products of such an industry may sometimes secure the substitution of a home supply for the foreign supply by means of quite a small protective duty, a small difference in price being sufficient to offset the local advantages enjoyed by the foreign manufacturer.

From the foregoing it will be seen that the facility with which an industry can migrate from one place to another is a quality on which much depends in the theory of protection. We need a word for this quality and we will call an industry that possesses it displaceable. The displacement of an industry does not necessarily or usually mean the physical transfer of labour or plant from one place to another, but its growth in one place and simultaneous relative diminution in another. Output in the former place is substituted for

output in the latter; the necessary labour and plant in the one are drawn out of the local supply and diverted so far as may be necessary from other industries, while labour and plant turned loose in the other have to be absorbed by other industries.

Displaceability is very closely related to elasticity of supply The more elastic the supply within the protected area, the greater the increase of output in response to a given rise of price of the product. The more elastic the supply outside, the greater the contraction of output and the less the fall of price in response to a given loss of markets. The factor of locality differentiates displaceability from the simple idea of elasticity.

The supply of a product may be localized in certain places, and be highly elastic in the sense that the organization for its production in those places is readily expansible or contractable in response to changes of demand. Yet, it may be that for want of the requisite capacities, natural or acquired, a country where the product has not previously been made cannot establish the industry without very heavy protection. Or, on the other hand, the supply of a product may be extremely inelastic, but a protective tariff may induce the skilled producers and workmen to migrate.

The simplest cases are those where there is some inelasticity of supply due to the law of diminishing returns. Agriculture and mining industries, which are dependent upon local advantages, tend to be relatively non-displaceable on this account. Among manufactures this is true also of the heavy industries, for which proximity to supplies of fuel and ore is a decisive advantage. Highly capitalized manufacturing industries are not easily displaceable, though in this case the obstacle to displacement may be only temporary. The capital needed for an industry is not confined to the plant actually used in manufacture. The establishment or expansion of an industry may involve a large incidental outlay upon housing, communications and public utilities, and this also must be taken into account.

Elasticity of supply is an abstract generalization which covers a great multiplicity of different circumstances, and this is even more the case with displaceability.

A protective duty upon a commodity permits of a difference of price inside and outside the protected area. In proportion as the protected industry is displaceable, the difference of price required to effect a given displacement (i.e., the exclusion of a given amount of imports) is small. But where the protected industries are on the whole very displaceable,

it is not to be inferred that, because the price difference is small, the total economic effects are small. For the diminution of imports must be matched by an equal diminution of exports. This will be brought about by the rise in internal prices generally and a consequent rise in costs, which impairs the exporters' power to compete in world markets. Where the exporting industries are also very displaceable, the disturbance will be small; a moderate rise in costs will be sufficient, and the result will be to substitute one set of manufacturing industries for another. But where the exporting industries are very non-displaceable, a relatively large rise in costs is necessary to restore equilibrium.

If it be asked what is the incidence of a protective duty, or rather, on broader lines, what are its effects upon the distribution of incomes, the displaceability of the industries affected is an essential factor in the answer. The prices of the dutiable commodities are in general raised above world prices by the amount of the duty (though in particular cases where imports are entirely excluded, and competition among home producers remains free, the rise may be much less). This rise of price constitutes a burden upon the consumer. On the other hand the general rise in prices and money values (including nominal wages) will diminish the real weight of the burden.

If the imports were very displaceable, and the exports very undisplaceable, the burden might be reduced to nothing. A low range of duties would effect a large reduction of imports, and the corresponding reduction of exports would necessitate a substantial rise in the prices of home trade commodities and in money incomes. The purchasing power of the ordinary earned income in terms of home trade commodities would be unchanged, in terms of exportable or duty-free importable commodities would be increased, and in terms of the dutiable goods might be very little diminished. Against this must be set a loss of profit to the exporting traders, and, as they gradually move into other trades, of economic rent to the owners of the land which provides the exportable commodities.

On the other hand, if a protective tariff is adopted by a country whose imports are very undisplaceable and whose exports are very displaceable, heavy duties, involving a large rise in the prices of protected commodities, will be required to exclude any considerable amount of imports, while a slight rise in the general level of prices will suffice to put the requisite check upon exports. In such a case the consumer will get little relief towards the burden of paying not

only the import duty itself but the rise of price on the home produced article, which goes to swell the profits of the producer and the economic rent of the landlord. There is in any case a limit to the rise of internal prices provoked by the tariff. If, to take an extreme supposition, the export industries were so undisplaceable that the rise in internal prices and costs made no diminution whatever in the total amount of exports valued at world prices, eventually the internal price level would rise to such an extent as entirely to nullify the advantage of the tariff to the protected industries. There would then be a uniform nominal rise in all prices and wages (except the prices of exported goods and of any duty-free imports that there may be).

The Government would be deriving revenue from the protective duties. If the world prices of the country's exports were unchanged, the whole of this revenue would ultimately be raised at the expense of the profits and economic rent drawn from the export industries. But in the not impossible case where the volume of exports is diminished, but the world prices of the exported goods are forced up, a part of the burden is placed upon the foreign consumers of these goods.

Displaceability is a quality very much affected by the individual circumstances of each case. In general " light " manufactures, that is to say, those which do not use any materials very heavy or bulky in proportion to the value of the finished article, are the most displaceable. They tend to be established at interposts where they have convenient communications with their markets and with the sources of supply of their materials. But interposts are many, and the choice of one interpost rather than another as a manufacturing centre is determined by various conditions, prominent among which is the cost of labour. By the cost of labour in this connexion we mean the money price of a given amount of labour, of given efficiency in the industry in question, when expressed through the foreign exchanges in terms of the currency of the markets in which the product is to be sold. Even when every allowance has been made for variations in efficiency, the cost of labour in this sense varies widely from place to place.

Cost of labour in any place depends *inter alia* on the skill of the workmen. Such skill tends to become traditional, and is then converted into a local advantage of the place where the workmen reside (but one that may be nullified if they choose to migrate).

The argument, so familiar in controversy, for the protection of infant industries, is based upon the possibility of

creating a tradition not only in the workmen's skill but in that of the producers who carry on the business. The tradition, once established, is a valuable local advantage. The same industry which was very non-displaceable when the tradition of skill was only to be found abroad, is eventually displaced, and thereafter becomes comparatively, perhaps absolutely, independent of the tariff under which it grew up. Whether it is then possible to abolish the tariff, and let the consumer get the profit of the new-found productive power, is another story.

Another particular case which has figured a good deal in controversy is that of the industry dependent on large-scale production. Large-scale production has a spice of magic in it; it is full of opportunities for an industrial Napoleon, who shapes his methods in every market to discover the weak points of his competitors, and lets loose massed columns of attack on his unsuspecting victims. The existence of such an industry highly organized in one country may practically prevent the development of a similar industry in several others, which are accessible to it, because potential competitors producing on a comparatively small scale could not manufacture at so low a price and cover costs. Put on a protective tariff, and a competing industry can be established and survive. And once started, it will tend to absorb the whole protected market, because, as its business extends, its cost of production grows less and less, and its advantage over its big foreign competitor grows greater and greater.

If the protected market is big enough, the industry may gain the full advantage of production on a large scale at its highest, and be in a position to compete on equal ~~terms~~ in the world market. This is a variant of the infant industry argument, but the industry in question need not necessarily be an infant. It may be a long-established one, which yet has never held more than a part of the home market. For example in the heavy industries, though production on a large scale is often a decisive advantage, transport costs also count for much. In a country with some coal and ore resources there may be iron, steel and engineering industries, which dominate such part of the home market as is in their immediate vicinity, but yet cannot compete against more powerful foreign rivals in the rest. A tariff may secure them the home market. And they may be permanently incapable of earning interest and overhead charges without the continuing support of the tariff in those districts where they are at a local disadvantage.

These are cases where an industry is displaceable, but only after a trial interval. The interval once successfully surmounted, the advantages of protecting a displaceable rather than a non-displaceable industry are felt.

To return to the general case of a country with non-displaceable export industries and displaceable import industries, we may observe that non-displaceability is usually the result of local advantages, and that a tariff may be regarded as hindering the access of the outside world to these advantages. The outside world can only buy their products with products sent in exchange. If these latter are checked by a protective tariff, the development of the local advantages is also checked. Labour is diverted from the export industries to the protected industries.

But that does not necessarily mean that the development of the country *as a whole* is retarded. For the effect of protection in this case is to improve the economic position of the working population mainly at the expense of the owners of economic rent. Immigration therefore becomes more attractive to foreign workmen.

The best illustrations of these conditions are to be found in new countries, where the population is sparse relatively to the local advantages, and only the most favourably circumstanced natural resources are worked. The resulting products are obtained at a cost of much less effort than in a fully developed and thickly peopled country, and wages must in any case be high relatively to world prices. A tariff on imported manufactures tends to draw away labour from the staple products, and the resistance of these latter drives up wages still higher.

Where the staple products are chiefly food, the level of real wages will be especially high. For the exportable food products will be procurable in the wholesale market at world prices, while the goods raised in price by the tariff will be manufactures, which figure less prominently in the working-class cost of living than food. If the country exports materials other than food, the position is still much the same, so long as food itself is not dutiable. For in that case food will still be procurable at world prices (*plus* cost of transport, if some food has to be imported).

In the opposite case, where the import industries are very non-displaceable and the export industries very displaceable, the former will usually consist of natural products. In so far as they are materials, the effect will be to raise the price of the finished products in which the materials are used. The rise of price will diminish demand, and may cause a great

disturbance by depriving the manufacturers of the advantages of large-scale production. Even where large-scale production does not prevail, or is of slight importance, it still appears flagrantly unfair to the manufacturers that their business should be injured in order to give protection to the home producers of materials. The grievance is more glaring still when the manufacturers are producing for export, unless they are allowed drawback of the duty in respect of the materials used in the exported goods. But the drawback, if it is to be fully effective in restoring the exporting manufacturers' power to compete in foreign markets, must be allowed on the home-produced material which has never paid duty, for that is raised in price just as much as the imported material. In view of these complications, protective duties on raw materials for manufacture have dropped out of vogue and are now rare.

The important case is where the natural products imported are the staple foodstuffs. The rise of price here falls on the consumers of food as such, that is to say for the most part on the working classes, of whose household budgets food forms the largest part. There is, it is true, a rise in money wages to set against this rise in prices. But owing to the relative non-displaceability of agricultural production, the reaction required upon exports is small and the rise of money wages is slight.

Suppose an intermediate case, where the dutiable imports were neither more nor less displaceable on the average than exports, and neither more nor less consumed by the working classes than commodities in general. If that were so, the results might so work out that the wage-earner would find his position on balance little changed.

There is a variety of protectionism in relation to which the foregoing analysis requires some modification, that is to say, a preferential tariff between two countries distant from one another, but united by a common sovereignty, or at any rate so intimately related as to aim at fostering their mutual trade by special measures. A preferential tariff presupposes a protectionist policy on the part of both the countries which are parties to it; both must discriminate against products of any third country. Against one another's products they impose either no duty at all or a duty substantially lower than against foreign products.

The effect of preference approximates to that of a single customs boundary embracing the countries concerned. Where they are contiguous, it does not present any special economic features, though there may be political complications.

A more interesting case is where they are distant from one another, and different in their economic characteristics. Preference is specially attractive to a highly industrialized country which possesses comparatively undeveloped dependencies. To such a country taken in isolation the advantages of protection are slight, and its disadvantages are at their worst. To extend its customs boundary so as to include the dependencies is to apply protection to an area with a quite different selection of exports and imports. The protected area exports manufactures and imports natural products at one end, but it imports manufactures and exports natural products at the other. The principal effect of the tariff may be to make the country and its dependencies trade with one another rather than with foreign countries, and to leave the composition of the exports and imports of each substantially unchanged. The effect of protection in each is then impaired by the preference given to the others. The possibility of such a re-arrangement of exports and imports is equivalent to both being very displaceable. Nevertheless the extent to which the countries embraced in the preferential tariff system can provide markets for one another's products is likely to be limited. On balance the whole system will be either an exporter or an importer of manufactures, either an importer or an exporter of natural products, and the effects of protection will correspond to the type of case.

We will consider next the effect of a protective tariff upon production and upon exports.

There is no presumption whatever that a tariff will of itself increase production. Against increased production by the protected industries must be set decreased production in the rest. Indeed the presumption is the other way, for there is certainly some virtue in the classical argument that an artificial diversion of productive power from the lines that it would follow under the sole guidance of a free market would diminish production.[1] It is easy to see that if two countries were hindered in making use of one another's local advantages they might in the end get less products for more effort in each of the industries affected.

On the other hand, if the industries affected are for the most part displaceable, the loss may be small. And there may be benefits which outweigh or are believed to outweigh the loss of production, such as a greater diversity of occupa-

[1] When we speak of " production " being increased or diminished, we are employing that elusive concept of a quantity of wealth, which was criticized in Chapter XVI. The discussion here must be read subject to those criticisms.

tion, or less dependence on foreign sources of supply for indispensable commodities.

It is only in a few special cases that there is an actual increase in production. It may be secured for example in the case of an infant industry, or in that of large-scale production fostered under a tariff up to the point at which it can furnish supplies cheaper than its foreign competitors.

Another example is to be found where production is diverted into industries in which the form of labour employed commands a higher price in the world market. Suppose that a country is almost entirely devoted to agriculture and simple manufactures, not entirely because of the physical characteristics of the country, but partly because its people have less natural aptitude for the finer manufactures than their neighbours. Protection of manufactures may lead to the consumer being supplied with less perfect articles at higher cost. But yet the total production of the country may be increased, because the people who are making watches or sewing-machines or motor-cars at 50/- a week would otherwise have been doing work of a lower grade at 30/-. It may be said that they ought to have been willing to do the skilled work under free competition at a wage so much lower than 50/- as might be necessary, provided it was still higher than 30/-. If they would, the argument falls to the ground. But a case can be imagined where the lower wage would not, in practice, be a sufficient inducement. And that is not necessarily sheer short-sightedness on their part. For the skill required may be only attainable at the cost of an expensive training, which the workman can only pay for out of increased future earnings. If the prospect of increased future earnings is sufficiently improved by the existence of a protected market, the training will be given, the workmen will be graded up, and their production thereafter correspondingly increased.

Against this increase in production in the protected country must be set a decrease in production in those which have previously supplied it with the commodities in question. But it is not *necessarily* the case that the productive power displaced in these latter countries will be degraded. The supplies previously received by them in exchange for their exports to the protected country may be replaced by supplies of a different character. It is thus conceivable that a measure of protection might in such circumstances increase production as a whole, but perhaps it is not very likely.

The case where the imposition or increase of a protective tariff improves employment is not here in point, because

that, when it occurs, is a transitory effect. It arises from the fact that the new tariff occasions a certain amount of monetary inflation, without the drawback of adverse foreign exchanges.[1]

Next we have to consider the claim that protection promotes an excess of exports. The manner in which the contraction of imports is reflected in an equal contraction of exports has been explained above. If the contraction of exports is less, that means that the country is accumulating credits abroad, and that process can only continue if these credits are turned into investments, that is to say, if the country exports capital. Is there any reason why protection should promote an export of capital?

In the transitional stage there may be an actual import of capital, for the equipment required to expand the protected industries is a new need, while the falling off in the capital needs of the export industries will only take effect gradually.

The volume of investible savings also is likely to be diminished, firstly because there will probably be some diminution in the amount of wealth produced, and secondly because, home trade being substituted to a certain extent for foreign trade, the proportion of the national income which takes the form of profit will be lessened.[2]

But against this reduction of volume must be set an *increase in money value* of the investible savings, reflecting the general rise in prices. To a country which is exporting capital this rise in nominal value is a very real advantage. If prices are 20 per cent. higher all round, the effort required to save £12,000 is no greater than the effort formerly required to save £10,000. When the £12,000 is invested abroad, the rights acquired for it are worth 20 per cent. more than those formerly acquired for £10,000. It is true that this does not appear to be so to the investor himself, because, when he receives a dividend of £600, it will only buy as much as a former dividend of £500. But the dividend has ultimately to be paid in goods at world prices. The goods when imported pay duty, so that the gain which the investor misses goes to the Government in revenue.

It may be said that the original export of capital would be accompanied by a shrinkage of imports, so that this gain of revenue is no more than the equivalent of a previous loss. For usually exports, being more specialized than

[1] See "Good and Bad Trade," pp. 232/8.

[2] Cases may easily be imagined where the reverse will be true. Big combinations sheltered under the tariff may secure swollen profits. Preferential tariffs with distant dependencies may promote long-distance trade yielding a high proportion of profit.

imports, are less affected by changes in the balance of payments. But the original loss of revenue corresponds to a real diminution of the tax burden on the consumer. The diminution of burden is not necessarily a full equivalent of the loss, but it may be very nearly so and in that case the State can make good the loss by taxation in other directions without inflicting hardship.

The financial power of the United States in recent years is a striking example of this advantage. There the natural tendency for wages and internal prices to be high in a rich new country has been accentuated by a protective tariff. Probably $10 can be saved in the United States with as little effort as £1 in England. The effect is felt whenever the Americans have to raise money to be spent abroad, whether they are participating in a business enterprise, buying old masters, financing a European war, or granting relief loans to mitigate its consequences.

If the tendencies to diminish the volume of investible savings in a protected country are inoperative or negligible, this rise in their nominal money value will mean a real increase in the amount of capital exported. Capital enterprises at home will be more costly, but only in the same proportion as prices generally. The same fraction as before of the total of investible savings will be available for investment abroad, and this fraction will represent a greater amount of wealth at world prices. To that extent the need for curtailing exports to balance the curtailment of imports will be avoided, and the requisite rise of internal prices will itself not be so great.

To a country which is an importer of capital, protection is likewise in some respects an advantage. The funds invested in it by foreign countries buy less physical capital, it is true, in proportion to the higher level of prices and costs. But then the extent of the openings offering a given yield remains physically undiminished. An investment which would formerly have attracted say £100,000 of foreign capital with the promise of a 6 per cent. yield, will now attract perhaps £120,000 and still yield 6 per cent. It will take precedence of rival openings in other countries of which the anticipated yield is less. On the whole approximately the same capital enterprises will be undertaken as if there had been no protective tariff, but the nominal amount of money drawn from abroad will be greater.

This greater nominal amount of money must be transmitted in the form of goods, and the goods will be imports paid for at world prices. Therefore what the investors pay

represents a greater volume of wealth than what the capital promoters receive The difference is substantially the duty on the imports, a windfall intercepted by the Government The adjustment may be effected in part not by an increase of imports, but by a contraction of exports. But the exports also are valued at world prices, and the benefit goes not to the Government but to the consumer. When interest and dividends on the capital invested have to be paid, payment must, it is true, be effected in goods at world prices (whether by a restriction of imports or an increase of exports). But the effort represented by the payment is still only proportional to the purchasing power of money.

Historically protection has always been a mercantilist policy. Even when it is recommended on the ground not of national strength but of individual welfare, the welfare is exclusively that of the individuals within the protected State, and, if it can be shown that their welfare will only be promoted at the expense of other individuals outside, that is regarded as an additional recommendation rather than a drawback.

Protection has accordingly acquired a sinister prominence, as intensifying national antagonism and jealousy It acts as a perpetual reminder that peace is potential war. Changes of boundary, transferring a district from one sovereignty to another, might be regarded as no more than a reconstruction of the organs by which the business of government is carried on, a matter which, apart from the taboos of patriotism, need not affect the interests of the individuals concerned very seriously. But the change from one tariff system to another is likely to cut across economic interests. Some producers in the territory transferred find themselves cut off from markets in the country they have left ; others find themselves exposed to new competition from the territory they have joined. Similar unwelcome changes are experienced by some of the producers in the remainder of both the countries concerned. Thus a protective tariff tends to promote the unity of the protected area and to interpose obstacles to partition or amalgamation.

This unifying tendency is appealed to by statesmen in recommending preferential tariffs for dependencies. They hope to bind their country and its possessions more firmly together by creating vested interests in their mutual trade. The possibility of such discrimination is a powerful reinforcement of the motives of Imperialism. The policy of preference greatly exacerbates the competition among powerful States for the acquisition of colonial dependencies. Even these

who do not believe in protectionism seek territory to keep it out of the clutches of those who do. The benefits which a country will in any case derive from the common sovereignty of its dependencies are all enhanced by preference. Foreign rivals with a tariff to surmount are all the less likely to participate in schemes of development and exploitation. Though the discrimination is not against foreign merchants but against goods of foreign origin, it will tend to favour the merchants who come from the same country as the favoured goods, and who are in touch with the producers of the goods.

Mercantilism is an empirical doctrine, and has never evolved a really systematic and comprehensive theory. In the preceding pages we have found that the results of protection differ widely from its ostensible aims. Yet some of its results are, for all that, quite in the spirit of mercantilism. This applies particularly to its effects on the export and import of capital. The effect of protection is that, with a given level of foreign exchanges, there is more money floating about in the country. The national income, expressed in money units, is greater. Or alternatively, if the supply of currency and the national income be supposed stabilized, the foreign exchanges are made favourable by protection, and the national income represents a greater command over objects of expenditure abroad. This is the kind of result at which the mercantilist rejoices.

The impassioned advocacy of protection as a remedy for unemployment is not mainly mercantilist. It is rather an endeavour to out-manœuvre the economists of the classical school, and to show that protection is the policy of welfare as well as of power. The economists are not slow to respond with proofs that free trade is the policy of power as well as of welfare.

Indeed there are some directions in which protection betrays the mercantilist ideals most lamentably. Mercantilism aims above all at fostering trade. Protection checks external trade; it checks exports as well as imports. If it checks external trade it probably diminishes profits. It diminishes the business of the great interposts. It diminishes the work to be done by the merchant fleet.

CHAPTER XXVI

FALSE ENDS

UP to this point we have been describing, analysing and criticizing the solution of the economic problem represented in the human society that we know. It is individualist in principle and organized through markets, and a great part of our exposition has been devoted to the working of markets.

Our concluding task will be to relate this examination of things as they are, to some of the ideas and proposals for improvement which occupy the minds of social reformers and political leaders. At this stage a brief recapitulation of the preceding chapters will be helpful

After the first two preliminary chapters, the next ten (III–XII) explained the working of the different kinds of markets, the commodity markets, the labour market, and the several branches of the capital market. They showed how the organization through markets reacts upon production and transport and upon the distribution of mankind over the surface of the earth.

The next three chapters (XIII–XV) dealt with human nature, the material upon which any solution of the problem has to work. We endeavoured to disentangle the principal motives, instinctive, traditional and rational, which especially affect man's capacity for joint action. Among the traditional motives we gave prominence to the taboos, religious and social, which still play so large a part in human society. And among the rational motives we gave prominence to those which are wholly or mainly sub-conscious.

We then passed (Chapters XVI–XX) to a criticism of the individualist system from the point of view of the welfare of the individual. Here we found two grave faults in the system. In the first place, by reason of a certain inertia in human nature, the individual is not competent to direct demand wisely. Wise spending calls for initiative, knowledge and taste, and for time and effort in the application of these qualities. The ordinary man neither possesses the qualities

in any great degree, nor can spare the time or effort. The result is that that power of directing human effort, which individualism places in the hands of the individual, is misdirected. The products, material and immaterial, to which human effort is applied are very largely superfluities, conforming to fatuous conventions or fashions.

Secondly the individualist system leads, mainly through the operation of profit, which is an essential feature of markets, to an exaggerated inequality of incomes. A disproportionate share of the power of directing human effort comes into the hands of a very restricted number of people, who have no special qualifications for using their power.

The remaining five chapters (XXI-XXV) are a marked contrast to the five that preceded them. We have been examining the aims which predominate in the minds of those who are actually engaged in guiding the legislative and administrative machine. It is to them, if to any, that the economic problem appears as a practical problem. It is they who have the power to change institutions, and therefore to move in the direction of a new solution.

If we seek to discover what use the statesman makes of his power, we find that he is preoccupied with questions of the type that we have been considering in the last five chapters, questions of national power, prestige and security, questions of markets, of foreign investments, of communications, of tariffs, questions of territorial expansion.

He cannot, it is true, altogether disregard questions of social welfare. One of the most momentous changes of the past hundred years has been the intrusion of such questions into politics under the pressure of democracy. The conception of the State as an instrument of welfare has begun to gain a footing, and the earlier conception of it as an association for attack and defence, and incidentally for discipline, has been challenged. On a superficial view of politics the change would appear to have progressed so far that in the more civilized countries welfare is the main object in view and the military-disciplinary functions of the State have dropped into the background. But such a view would be mistaken.

Up to a certain point there is no very clear divergence between the two conceptions of the State, so far as practical consequences are concerned. Distress and discontent are sources of national weakness. The statesman who sets out to promote the breeding of cannon-fodder must make life possible for his victims. And, what is still more to the point, the same wealth that promotes national strength may promote individual welfare.

At the other end the reformer whose object is to use the State as an instrument of welfare finds the field of his operations limited to his own people. He may be a cosmopolitan devotee of humanity, but he can only legislate for his own country. In practice his outlook is as limited as that of his fire-eating rival, and the two will often find themselves supporting the same measures.

Questions of welfare figure more prominently than those of power in practical politics. But that is because they provoke more difference of opinion and more discussion. Questions of power are in detail the preserve of experts. In principle there is nothing to discuss because everyone is agreed.

When the two aims clash, it is power that prevails and welfare that gives way. Enthusiasts for any social reform do not press it against the argument that it will weaken the country; they feel bound to meet the argument, or, if they cannot, to modify their proposals. If possible, they not merely meet the argument but endeavour to prove that the measures which they are really advocating as means of welfare will actually promote the national strength.

So long as peace is potential war, and national security depends upon national power, the position could not be different. No statesman can take the responsibility of weakening his country. Nevertheless, the change that has taken place is profound. Though the policy of welfare cannot, under those conditions, actually prevail over that of power, yet within the wide limits allowed to it it has made very notable headway.

The two policies represent two rival solutions of the economic problem. The problem is how to direct the joint action of a human community. The two policies offer two rival ends to be sought. But the region within which their rivalry can make itself felt is small, because far the greater part of the solution of the problem in the existing state of society is beyond the reach of policy. The solution has grown up. Individualism is a natural growth. Leaving the motives of the individual free play through freedom of contract, it avoids the prodigious task of planning the co-operation of innumerable separate wills. Historically it came into being as a reaction against the rigid mediæval caste system, or rather against so much of that system as had survived to the 18th century. It was advocated as a means of welfare. Each man, it was argued, if left free, would best seek his own welfare. His freedom should only be so far limited as was necessary to safeguard the freedom of

his neighbours. But the change was really only one of degree and not of kind. For, on the one hand, something had always been left to free bargain in the market, ever since division of labour had prevailed at all; on the other, individualism undiluted has never existed and could not exist. The obligations of caste on which mediæval society was based could not be modified; they could be destroyed but could not be reconstructed. Progress could therefore only come through the abrogation of obligations and towards liberty. This process had been steadily at work for centuries, when Adam Smith started the classical school of economists; the difference thereafter was that it became more self-conscious.

The economists of the classical school regarded welfare as the end of economic activity. Adam Smith was keenly alive to the paramount claims of national power, but rather as imposing limits upon the pursuit of welfare than as supplying a rival end. The influence of the classical economists brought welfare prominently into the practical legislation of the democratic period of the 19th century. The legislation was mainly *negative*. It was directed rather to the abolition of unnecessary and undesirable limitations upon liberty than to the constructive creation of new institutions. But for all that the new inspiration marked a radical change. And the inspiration was philosophical. Utilitarian hedonism was, no doubt, a very limited and a very pedestrian philosophic creed. But it was pre-eminently a coherent and intelligible one. Its influence extended beyond the economic sphere into all branches of politics.

A momentous outcome of the growth of the utilitarian school was the beginning of what has since come to be called pacifism, an unreserved condemnation of war as something utterly bad. There was no room for war in the utilitarian ethics. It could never promote the greatest happiness of the greatest number. A war waged in a great humanitarian cause might supply an exception, but only if it were successful, and even then it was only necessitated by the wickedness of the other party. Most wars were unmitigated evil, and the Crimean war supplied a pertinent example in the period of the early enthusiasm of the Manchester school.

This pacifism of the Manchester School was noteworthy in that it had a political and philosophic basis. Pacifism had existed before, but it had been based on religious taboos. The Quakers had interpreted Christianity as forbidding war. But they could only appeal to people who were disposed to take the same view of Christian teaching as themselves.

The Manchester School found allies in the Quakers, but their main support came from other directions. The utilitarian philosophy was easily understood ; it appealed to practical men of business, who were ready to be convinced of the beneficent effects of their own activities in supplying their neighbours' needs, and of the irrationality of a disturbing cause like war, that would interrupt the process.

The pacifism of the Manchester School was powerful because it commanded support among the manufacturers and merchants. The mercantilist camp was betrayed from within. This state of things was not natural, and was not destined to last The pacifist movement was almost entirely English. What made it possible was that for the moment English manufactures and trade were supreme over all competition, and England had a monopoly of Imperialist expansion. In the mercantilist's potential warfare, the English traders did not feel themselves threatened. Their protest was not against this potential warfare, but only against literal war. They did indeed disapprove of Imperialism, but that was because it could not be pursued without violence. And if a régime of universal and unmitigated individualism could be established throughout the world, the advantages of territorial expansion would evaporate

During the last thirty years of the nineteenth century, the competition of foreign manufacturers became more and more formidable, and Imperialism revived with the partition of Africa. The pacifism of the English manufacturers and merchants as a class faded away, though enough of it survived among individuals to maintain the continuity of the Manchester School.

The Manchester School ceased, however, to be the principal exponents of pacifism. They yielded place to the Labour movement. The Labour movement, like utilitarianism, is pacifist because it champions the ideal of welfare against that of power. It differs from utilitarianism in that it does not accept the free play of the market as the means. In general its hostility to individualism is based upon the inequality of incomes, not upon the shortcomings of wealth itself as the economic end.

Closely related to the Labour movement is Socialism. A generation ago Socialism could be defined as aiming at the nationalization of the means of production, distribution and exchange. That sweeping programme was to make the State the sole capitalist, the sole employer and the sole trader. It was a solution of the economic problem based not on markets but on authority, and was to bring the joint

action of the community under the control of the human will as never before Nowadays, Socialism is not limited to the full revolutionary form of collectivism, but has come to include a wide variety of ideas and tendencies, of which the common characteristic is the employment of the State as an instrument of welfare.

It is not confined to correcting the inequality of incomes. The full programme of collectivism might be regarded as primarily directed to that purpose But it included constructive plans for using the resources which were to be centralized in the hands of the State. Profit, interest and rent as constituents of private incomes were to cease, but the purchasing power thus lost to the private individual was to accrue to the State, which could use it for the common benefit. There was in reality nothing in this programme to conflict with the policy of national power, because the State oould use its resources as well as before for its own security or aggrandizement. But the inspiration of Socialism was humanitarian and idealist, and this is still more true of the more recent variants of it, and of the partial applications now covered by the name. The general tendency of these developments has been to dissociate Socialism from the ambitious scheme of placing all economic responsibility upon the State, and basing the entire solution of the economic problem on authority.

The world's experiences since 1914 have given a new significance to pacifism. War is recognized to be so transcendent an evil that the desire to find the means of getting rid of it extends far beyond the circle of any particular religious or economic creed. Instead of merely being challenged by a rival ideal, the policy of power is widely condemned on its merits. Escape from war is being sought by way of international disarmament and arbitration, through the instrumentality of the League of Nations.

Of all practical issues with which humanity is faced, this is the most urgent. In this book, however, we are approaching the question from a somewhat different standpoint. We are examining the ends to which the joint action of mankind ought to be directed. We find that one of the ends to which it is in fact directed is national power. To this end war is incidental, and if the end itself could be eliminated, war, at any rate international war, would be eliminated with it. But it is conceivable on the other hand that war might be eliminated and the pursuit of national power continue.

In the conflicts of national power war is an exceptional episode. The most Imperialistic statesman aims at using his

country's power to accomplish his ends without war, just as a good dentist aims at giving relief without extracting a tooth. Diplomacy is war without violence and treaties record the results of this war. Arbitration based on national rights would have the enormous advantage of divesting international disputes of any reaction upon prestige, but it would still merely enforce treaties which were originally the product of national power.

Ultimately, it may be contended, a system would grow up in which power as the basis of treaties and rights had slipped into the background and been forgotten, and then national power would no longer be valued. In reality, however, this cannot easily be brought about. In the international system each nation, large or small, strong or weak, is deemed sovereign in its own territory, and is entitled to exploit its own local advantages in complete disregard of the interests of all others. If all could be relied on to use their sovereign rights generously, a code might grow up and acquire the force of law for the purposes of international arbitration, prescribing the manner in which any country might use local advantages in which the interests of others are concerned. Examples of such local advantages are interposts, means of communication, supplies of natural products, openings for capital enterprise. A code to safeguard foreign interests in local advantages of these kinds would involve a most revolutionary impairment of sovereign rights, and in the present state of international opinion and feeling it could not be started.

Each country is likely to continue to cherish its own sovereign rights, these rights forming a rigid system which can only be modified by voluntary bargains. The bargains may conform to either of two types, according as the relative power of the parties does or does not affect them. Undoubtedly in many international bargains the relative power of the parties can be, and is, completely disregarded. And, where power does enter in, it is often so nicely balanced as in practice to produce a fair bargain. Sometimes a settlement is imposed by great Powers upon little, in which no one great Power can afford to serve its own interests, and all are thus compelled to act in an impartial manner. There remain the cases where the great Powers exercise pressure on the little to get concessions for themselves or their people, or where, though the inequality is not so marked, relative power is the deciding factor.

If the relative power of the parties were absolutely disregarded, and each country made its bargains entrenched

in an indefeasible sovereign right, there would be a serious loss of elasticity. In those cases especially where sparse and backward populations or decayed and inefficient governments were in exclusive control of regions of great economic possibilities, respect for right might put more strain on the natural covetousness of powerful neighbours than human nature could bear.

Modern history abounds with examples of the kind of situation that is likely to arise. In the period before Napoleon took over Louisiana from the Spaniards and sold it to the United States, perpetual trouble was caused by the interference of the Spaniards with the navigation of the Mississippi upon which the economic life of American States that were growing up west of the Appalachian Mountains was dependent. This intolerable situation was ended by the Louisiana purchase without war, but that was only because Napoleon could not defend his new dependency against England, and was glad to get rid of it.

A little later in American history Texas, being a part of Mexico, began to be settled by immigrants from the United States. In a few years such was the predominance of the American settlers that they organized a rebellion against Mexico, and accomplished first the independence of Texas, and then its annexation to the United States. The territory devolved upon the nation which was competent to settle and exploit it. The change of sovereignty was effected without open war between Mexico and the United States, but not without violence.

A very similar situation in California led to open war. The defeat of Mexico added California and neighbouring territories to the United States.[1]

The Panama Canal is another illustration. Here the question was one not of immigration, but of a great capital enterprise, undertaken by the United States Government. The Isthmus that was to be the scene of it was part of Colombia. The inhabitants were seized with an unexplained but very convenient desire to secede from that State, and to place themselves practically under the authority of the United States.

Another example is supplied by the South African War. Rich gold mines were discovered in the midst of the territory of a community of remote and independent farmers, who neither cared to turn gold-miners themselves, nor welcomed the immigration of a foreign gold-mining population. The

[1] See "American History and Geographical Conditions" by Miss E. C. Semple (Chapters IX and XI).

immigration, nevertheless, occurred on a large scale; probably it could not have been prevented. The hostility of the Boers to the strangers made itself felt in various restrictions and disabilities, and, after intricate negotiations amid intense mutual distrust, force was resorted to.

The South African War like the quarrels of the United States with Mexico arose out of the intrusion of a foreign colony to exploit the local advantages of the country. In recent years restrictions on immigration into new countries have grown commoner. In course of time these restrictions may be a fruitful cause of international jealousy and friction.

It may sometimes be better that the natural resources of a country should *not* be developed. Gold is a special case, but if we leave it aside with all the controversies connected with it, we should hesitate, after our critical examination of wealth and of the objects of consumption, to say of other products that an increased supply would always be a gain properly measured by its money value. At any rate, if international peace could be secured at the cost of leaving a certain amount of the world's natural resources in the control of people unable or unwilling to develop them, the price might be well worth paying. But the difficulty is that the greed of wealth, even if it be separated from the pursuit of power, is almost certain to break down the barrier of right in such cases. In that contingency national power would regain its importance, and the mere expectation that it would do so would make its elimination from international relations impossible from the beginning.

Further, if we can imagine a world in which all possibility of international conflicts had been completely excluded, so that national wealth could no longer be desired as a means of military power or prestige, that would still not bring to an end the pursuit of wealth by nations. The preceding chapters have amply shown how the nation and the individual play into one another's hands in the pursuit of wealth. Under an individualist system a nation is only rich if it is composed of rich individuals. The individual therefore, claims the favour of the State in becoming rich.

But even if he can no longer represent himself as furthering an essential public end such as national power, it is not to be supposed that he will be content that the State should disinterest itself in his activities. The use of the authority of the State remains vital to some of his projects, and he will seek to exert influence upon it.

This he is in a position to do. He need not resort to anything so elementary as corruption, except in those primitive

or degenerate countries where that is the recognized method of securing services and concessions. In a country where honourable standards have been preserved among public men, the rich man's influence is firmly founded upon the value of his favour to his fellows. He can give to charity, can patronize art, letters, the drama or the press, can give to political funds; and the beneficiaries of these activities, whether actual or potential, will all be predisposed to conciliate him. But this is not the most important factor in his influence.

As a capitalist he is a unit in the investment market. The seekers of capital depend on the favour of the investment market. A single fortune large enough to be courted for its own sake, is, no doubt, an exception. But the capitalist, who is not in this special position, but whose resources are nevertheless considerable, can if he chooses, enjoy his share of the influence which belongs to the limited class of which he is a member.

The seekers of capital are themselves an influential class. They are influential as sellers of valuable shares, as givers of big orders to contractors, as buyers and sellers of commodities, as employers of labour. The power of the capitalists is great because it is exercised over people who in turn are thus powerful.

And the capitalists and the seekers of capital are to a great extent *the same people*. Everyone who is safely entrenched in the goodwill of an established business is qualified to be both. At one time he is seeking fresh capital for the extension of his own business, at another he is seeking investments for his accumulations. Sometimes he will be doing both at the same time; he will be seeking outside capital for his business through issues of debentures or shares, in order to release his own resources for some new enterprise.

Thus all those interested in *profit* possess the solidarity of a class knit together by an intimate community of interests. Every member of the class so far feels himself dependent upon the others that he is inclined to make common cause with them whenever his own interests are not directly and adversely affected. The politician often has to listen to the voice of the business community speaking as a unit. He is all the readier to listen if he believes that the interests of the business community are inseparably bound up with national power. But even if this motive were removed, he would still be strongly predisposed to defer to so powerful a group.

The power of the business community is further increased by direct influence over the channels through which opinion is propagated. The newspaper press is itself a branch of business, and has latterly been coming in all countries more and more into the hands of big capitalists. And it is in a special way related to other branches of business through the use of newspapers as a medium for advertising. Every successful newspaper is dependent upon its advertisement revenue for more than all the difference between profit and loss. It is apt, therefore, to be susceptible to pressure from the firms who advertise in it. Direct pressure would be resented by a self-respecting newspaper proprietor as a form of corruption. But even he can scarcely escape being affected by the community of his interests with the advertising firms. The politician who antagonizes business will probably antagonize a great part of the press.

In a country with parliamentary government or any form of government dependent on the free play of parties, rich men will secure influence through subsidizing the organizations by which party propaganda and electoral campaigns are carried on. And where a political career, if not impossible, is difficult to follow without independent means, the government and legislature are to a great extent manned by the rich, whose power, as a class, is thereby further increased.

It will be seen, therefore, that plutocracy, though under existing conditions it is in intimate alliance with mercantilism and imperialism, is nevertheless an independent influence, which might exist without them. It is founded upon the pursuit of money for its own sake. The pursuit of the goods or "utilities" or "satisfactions" that money can procure could never be so persistent, so single-minded, so sustained. It would always be limited by a satiety point.

The cult of money-making and the cult of national power have this in common, that both are directed to what may be called *false ends*. By a false end we mean something which is so generally and almost certainly valuable as a means, that people seek it without considering for what end it is to be used, and eventually they become content to seek it without using it for any further end at all. Money and national power are both examples of false ends.

Welfare we have so defined that it must be composed of true ends. We may go astray in determining which particular experiences are to be included in welfare; we may believe to be good what is really bad, or bad what is really good. But whatever we rightly judge to be good as an end we rightly judge to be part of welfare.

Can we be sure that national power ought not to be regarded as good in itself, and therefore a constituent of welfare? Some philosophers believe in a good of the State which is different from the good of the individuals who compose it, or of any of them. That is to say, they set up the good of the State as an end, in contradistinction to the view that the State is an instrument or means for promoting the good of individuals. Anything approaching a thorough discussion of that doctrine would trespass on the domain of metaphysics. For our present purposes the following brief observations will suffice. In the first place the good of the State would be an ethical end which is not in any consciousness. Only individuals have consciousness. That only conscious experiences can be good or bad as ends may seem a dogmatic statement, but it accords with common sense, and it is hardly going too far to say that all apparent exceptions to it can be explained away, usually as arising from a confusion between ends and means.

We have already pointed out the overwhelming claims made on behalf of the State. These claims are expressed in the form of taboos, enjoining devotion to the State. A taboo, even if it serves a rational purpose, is not ostensibly based upon that purpose. If it were, it would not be a taboo, but a precept of reason. The taboo is enjoined as a self-sufficient rule, not requiring support from reason. The taboos of primitive religion have frequently been rationalized by the supposition of the existence of divinities towards which they are directed. In the same way the State has been hypostatized, and the taboos of patriotism have been given an object in the "good" of the State.

To deny the good of the State as an end is not necessarily to exclude the conception of the State from ethics altogether except as a means. Given that the ends of ethics are to be found only in the minds of individuals, we still have the fact that the conception of the State is often itself an object to the mind, and enters into the individual's sentiments and emotions. Even if it is thought of as a means, it is then a constituent in a mental experience which may be regarded as an end. And often it is not thought of as a means at all. It would be ridiculous to suppose that, whenever a Frenchman loves his country or feels proud of it, he conceives France as an association of people for promoting their welfare and security.

It is therefore entirely natural that many people should be led to think of the State as an independent entity, whose good is an ethical end. On the other hand we are bound

to admit that their view is not necessarily explained away by merely showing how it may have grown up.

We can afford, however, to leave the point undetermined, because in the aims of the mercantilist or the imperialist the State is treated essentially as a means. If the good of the State as an end has any real meaning, it is not there that we shall find it.

Power is relative. One State's gain of power is another State's loss. When the imperialist's ideal of complete subjection of all his neighbours is achieved, he must weep like Alexander ; for the relation that he has been striving to establish vanishes for lack of terms to be related. And under more ordinary conditions all that power can give a State is freedom to pursue its own ends unmolested by enemies.

Plutocracy and mercantilism act in alliance, because they have a common basis in money-making. Money must here be taken in an extended sense, as in our investigation of the love of money in Chapter XIII. It comprises all rights to money, and those possessions, like investments, which are held on account of the money income that they yield, as distinguished from those which are acquired to be consumed or enjoyed.

This common basis is money and not wealth, for to the mercantilist statesman money spent on consumable commodities is lost. He seeks not wealth, but the power of drawing on wealth at need. The wealth to be drawn upon will come from the resources of individuals, who can be made or induced to contribute by tax or loan.

Ultimately, it is true, the State *may* have to use its power of drawing on the individuals' money ; it may have to turn this money into wealth for equipping and moving armies and fleets. But this is exceptional. Under the conditions of diplomacy statesmen match their weapons against one another in a potential war conducted without violence National wealth, which is one of the foremost of their weapons, is therein *used*, but not *used up ;* it only begins to be used up when potential gives place to actual war. The statesman who avoids war, and wins victories of prestige, both eats his cake and has it. So long as that is so, the money-making individuals remain immune from the sacrifices which actual war would entail.

But it is a condition of success that their resources should be such as *could* be mobilized for war if required. They must be made available through markets in the ways we have already described, and particularly through the invest-

ment market. What the mercantilist would encourage is accumulation by the individual. The sums accumulated are put into investments. Expenditure upon consumable commodities comes to be regarded as a weakness. Nations exploit this weakness in one another by selling exports. Apart from national debts and one or two similar classes of securities, income-yielding investments themselves depend upon the selling of products to consumers, that is to say upon exploiting somebody's weaknesses.

The producer is a parasite feeding on the spending propensities of the consumer. Upon the instincts and proclivities of these parasites and their victims the mercantilist statesman founds his solution of the economic problem. He treats the parasites as he would bees that accumulate honey.

Expenditure in some forms is indispensable or desirable, and the producers who supply it are a beneficent class of parasite. But that makes little difference to the mercantilist, it merely means that the victim is dependent upon the parasite, and more completely at his mercy.

The metaphor is incomplete. The producer and the consumer are substantially one and the same. The parasites are themselves the victims, the bees are the flowers in another aspect. Every individual has a debit account in his capacity as victim and a credit account in his capacity as parasite. His accumulated fortune is the excess of the credit over the debit.

The excess of credits in the aggregate over debits in the aggregate is represented by the net aggregate of investment capital. This net aggregate does not exactly coincide with the aggregate of physical capital. It consists of valuable rights some of which are represented by physical capital, but others partly or wholly by goodwill. Goodwill or capitalized profit can in a sense be regarded as offset by a corresponding debit against the consumers whose exploitation it represents. But this would be an artificial interpretation and not a very plausible one, for there is no *obligation* upon the consumer, and those, whether producers or dealers, who gain the profit render services in return. In the case of national debts on the other hand there is an obligation, and, in so far as they are not represented by physical capital, there is no service rendered to the taxpayer or consumer. They are debits against the debtor communities and chiefly interest the mercantilist when they are owed to foreign creditors.

To the classical economist who thinks of production solely as a necessary preliminary to consumption, the

mercantilist's view of consumption as a weakness or a debit is the height of paradox. Nor could such a view have prevailed, but for the extensive and flagrant misdirection of consumption which we examined in Chapters XVII and XVIII.

In the condemnation of riches as an unworthy end of human activity there is no novelty. Serious opinion has never been really deceived by illusions of the desirability of wealth. Contempt for luxury and extravagance is not peculiar to puritans and ascetics, but is fully shared by many of those who indulge in such expenditure. Spending is evidence that the spender can afford to spend, and the more superfluous the objects of expenditure are, the better the evidence of ample spending power. But the satisfaction to be derived from the social ambition based on a display of spending power is in reality very limited, and the rich man who has good sense, but who has not the special faculties and tastes which would enable him to spend with more discrimination and wisdom than convention prescribes, tires of spending and prefers to accumulate a great part of his gains.

Thus the vanity of riches plays its part in the motives of money-making as well as in those of mercantilism. Neither money-making nor mercantilism could realize their ideals adequately till the creation of the modern investment market opened the way to accumulation on a grand scale. The investment market in turn depends upon modern developments in the provision of fixed capital for industry and transport.

Mr. Keynes has pointed out, in the much quoted opening chapters of his *Economic Consequences of the Peace*, how greatly society depended, in the period that preceded the war, upon the passion for accumulation. Accumulation meant the increase of fixed capital, and the increase of fixed capital meant the facilitating of production. If the money-making ideal were pushed to its logical extreme, everyone would abstain from unnecessary consumption, and all effort not required for present necessary consumption would be devoted to diminishing the effort required to provide for future necessary consumption.

That would, of course, be an absurdity. The vanity of riches is relative, and human nature accords it even within its limitations only a partial recognition. Indeed an absolute abnegation of all wealth beyond bare necessities would to the individual be a confession of failure in the economic sphere.

But the mercantilist diverges at this point from the individual money-maker. He would like to see all people, rich and poor, living the simple life, consuming just what conduces to their physical and mental efficiency and no more, and accumulating an ever-growing stock of fixed plant which, in so far as it is not adapted to supplying this desirable consumption, is fitted for the purposes of armaments and war.

Mercantilism pushed to this extreme merges in militarism. Militarism is no more than the cult of national power pushed to its logical conclusion. It is the complete subordination of the end of welfare to that of power. It subsists on the principle of sacrifice. The taboo of patriotism exacts the surrender of all interests, personal and material, to the paramount authority of a State organized for war. The magnitude of the sacrifice becomes to the people a measure of the magnitude of the object for which it is required. The object so magnified is accepted as justifying the sacrifice

Militarism in one country provokes militarism in its rivals. They cannot afford to be surpassed in military preparation. Competition in armaments intensifies the economic burdens, and if the sacrifice surpasses a certain limit, the competitors fear that they cannot sustain it. They are driven to concentrate upon preparation for an early conflict to determine the balance of power, so that, a decision once obtained, they can relax their efforts.

Plutocracy likewise can be pushed to an extreme. The great capitalist finds national boundaries too narrow. Their extension through imperialism is restricted by the imperialism of rivals. To the capitalist whose interests are international the conflicts of States become a vexatious interference with business. He diverges as much as the militarist from the alliance of mercantilism and plutocracy.

CHAPTER XXVII

WAGES AND THE LABOUR MOVEMENT

AT the present time the great assailant of the individualist system is what is broadly and rather vaguely summed up as the Labour Movement. The Labour Movement really includes four separate movements, which are loosely related together.

First there is Trade Unionism, which organizes the marketing of labour. It has the twofold function of enabling workmen to bargain through leaders who know something of the market, and of supplying them, through the power of striking, with a weapon for enforcing demands upon their employers.

Secondly there is the Parliamentary Labour Movement, which aims at the election to representative legislative assemblies of deputies who are themselves of the working class, and who can be relied on to use their position to further the interests of that class.

Thirdly there is the movement known as Syndicalism, which aims at using the trade union weapon of the strike to attain political ends.

Fourthly there is Socialism. Socialism has no necessary connexion with the Labour Movement in any other form, but circumstances have associated them closely together. It is really in virtue of this association that we are justified in regarding the Labour Movement as antagonistic to individualism. Trade Unionism is quite in place in an individualist system. A Parliamentary Labour Party, though it is likely to tend towards Socialism, might find plenty to do within the four corners of individualism. Up to a certain point the same is true of syndicalism, though syndicalism if pushed to its logical conclusions is almost bound to lead to Socialism of a kind.

We shall defer an examination of Socialism till the next chapter, and for the present we shall confine ourselves to the other phases of the Labour Movement.

The primary function of Trade Unionism is to organize the marketing of labour. Its chief concern is with the price at which labour is to be sold. It may include other stipulations besides price in its bargaining, but from the point of view of the employer, who is the other party to the bargain, these stipulations can practically be expressed in terms of their cost to him. They occasion an addition to his cost of production, just like an addition to his wages bill, or, if not, he need not make much difficulty about accepting them.

If we regard a trade union as setting out to settle the price of labour in the market, we are led to ask what power it really has of doing so. It is obvious that it cannot raise wages without limit. But if not, what is the limit? And what happens when the limit is approached or passed?

These questions arise, whatever the prevalent method of settling wages may be, whether by collective bargaining, by unregulated individual competition, by legal enactment, or any other system. We have shown how profit is related to cost of production, and how the constituent elements of cost of production are all related to the cost of human effort. It might perhaps be supposed that these relations taken together supplied a complete solution of the problem of wages; but that is not so. What they determine is an ideal or normal scale of remuneration, from which the rates actually paid may differ materially. When this ideal scale, which we may call the economic rate of wages, prevails, the employers gain a normal profit, ultimately limited by the income to be expected by potential competitors in the industry. Employers who pay less than the economic rate of wages receive the difference in the form of extra profit. The extra profit is a perquisite of the employment of underpaid workmen, and if it were possible to obtain a further supply of such workmen, competitors would come into the trade to secure the exceptional profit. But in that case the new workmen must either have been unemployed or they must have been tempted away from other trades. So long as it is possible to recruit labour from these sources, equilibrium does not exist, and the conditions which determine the economic rate of wages have not been established. In fact the entry of competing producers with their workmen into the trade will increase production and will lower prices and profits. When this process has worked its full effect, wages may still be below the economic rate, and profits correspondingly swollen.

This state of affairs may exist in one industry, in several,

or in all. If it exists in all, if the market rates of remuneration in all occupations are below the economic rates, then all employers as such will be receiving extra profits, profits, that is, which are above the normal proportion to the profits of those, such as merchants and financiers, who are not to any important extent employers. There would, no doubt, be a tendency for people to start new productive enterprises in order to share this extra profit, and they would seek to draw away workmen from the existing concerns. *If* the workmen were alive to the position, they could take advantage of this demand for labour to obtain better wages, up to the point at which the employers' extra profits were extinguished. In other words equilibrium would be regained, and the economic rate established.

But these tendencies towards equilibrium may work very slowly—so slowly as to be practically inoperative. Competitors can only be attracted in from outside if they have some means of estimating the profits to be made. Existing employers may conceal their profits, and it may be difficult, without the data yielded by their experience, to foresee the profits of a new venture. The existing employers themselves will probably refrain from drawing away one another's workmen ; each of them will feel that to start doing so would be to create a very dangerous precedent. Even when these preliminary difficulties are over, and the demand for labour is beginning to make itself felt, the workmen may delay a long time beore they realize their opportunities. And when they do, unless they are organized, they may fail to take advantage of them.

When the error is the other way, and wages are above the economic rate, the employers' profits are reduced below the normal. Suppose that this occurs in one industry, and assume in the first place that the industry produces a home-trade product, so that foreign competition does not enter into the question. The natural recourse of the employers is to raise the price of the product so as to restore their profits to normal. But the dealers who intervene between them and the consumers will not allow their profits to be encroached on, and the rise of price will therefore in general be passed on to the consumer. At the increased price there will be some contraction in demand, and the productive capacity of the industry will be incompletely employed. The entry of fresh capital into it will be thereby discouraged, and in the less successful concerns the renewal or even the maintenance of existing capital may be neglected. This shrinkage of capital, the ultimate extent of which will

correspond with the shrinkage of demand, will be accompanied by a diminution of the number of workmen employed. Unless therefore the increase of wages above the economic rate is to be nullified by a growth of unemployment, the entry of recruits into the industry must be limited. Inasmuch as the artificial rise of wages would in itself tend to attract recruits, some positive action will be required to exclude them.

The intensity of these effects depends upon the elasticity of demand for the product. If the demand is very inelastic, if, that is, a given rise of price occasions a very small contraction of demand, the effects are correspondingly small. If the demand is very elastic, the effects are large. The elasticity of demand for a commodity is not, even at a given place and time, a definite mathematical function. The response of demand to a change in price depends, among other things, upon the manner in which the change comes about ; all sorts of psychological vagaries may come into play to upset the most carefully reasoned expectations. Nevertheless some cases can be fairly clearly distinguished. The demand for the necessaries of life tends to be inelastic, except in so far as one product can be replaced by another, or where there is room for reducing waste. The same is true (with the same exceptions) of a product which enters into the manufacture of something else, but only accounts for a very small part of the price of the finished product. In such cases either workmen or employers or dealers can by concerted action levy a tax upon the consumers for their own benefit.

An important particular case is that of public utilities. These are wholly or partially local monopolies, and the charge to the consumer is controlled by authority. If wages are pushed up, the charge to the consumer can usually be increased. If the public utilities are the enterprises which supply a large settled population with transport, with postal telegraphic and telephonic facilities, or with water, gas or electricity, the consumers may be forced to pay considerably higher charges, for they have no alternative short of migrating to another place.

The full power of forcing up the price of the product by restricting production only exists in a home trade industry, which does not have to meet foreign competition, either in export or in import markets. An industry which has to meet foreign competition can only force up prices, if at all, to a very limited extent. It has to sell at the world price. and it is only in exceptional circumstances that a restriction

of output in one country will materially affect the world price (e.g., where it contributes a large proportion of the entire world supply, or where the product is so bulky or heavy in proportion to value that international competition in any locality is limited to sources of supply in the close vicinity). Where the world price remains practically unchanged, the full effect of a rise in wages is felt in the diminution of profits. The closing down of the less profitable businesses thereupon proceeds, and production falls off accordingly, and, because the falling off of production does not raise prices, the process must go on all the longer.

The extent of these effects depends upon the circumstances of the industry and especially upon the relative proportions in which wages on the one hand, and interest and overhead charges on the other contribute to cost of production. An industry in which nearly all the costs are labour may be almost wiped out. One which is heavily capitalized may continue its output undiminished.

Numerical examples will make the difference clearer. Suppose an article is made at a price of 10d., composed as follows:

	d.
Labour	7½
Materials	1
Interest and depreciation ..	0½
Profit	1
	10d.

Let the cost of labour increase by 10 per cent., or ¾d. Profit is thereby reduced to ¼d. A manufacturer whose annual output is 240,000 articles would find his income reduced from £1,000 to £250. If he is working with his own capital, he also gets such part of the £500 for interest and depreciation as represents interest, say £160. He can only abandon the business at the cost of sacrificing a part of this capital (not the whole, because he can realize so much of it as is circulating capital, and can probably sell a part of the fixed plant, such as land and buildings, for something more than scrap value). He may, nevertheless, see his way to improve substantially upon his existing income of £410, by taking up some other business.

Compare on the other hand a highly capitalized business, where the cost of an article priced at 10d. is composed as follows:

	d.
Labour	5
Materials	1
Interest	1
Depreciation	2
Profit	1
	10d.

Labour goes up 10 per cent., or ½d. As labour forms a smaller proportion of total cost, this makes a smaller inroad upon profit. It is true that the profit is halved, and the income from an output of 240,000 articles is reduced from £1,000 to £500. But if the manufacturer is working with his own capital he is receiving £1,000 a year in interest, and his income is reduced only from £2,000 to £1,500. If he is working with borrowed capital and receives only £500, he may think he can do better in another business. But in that case the owners of the capital cannot afford to let the business close down. They must enter into possession of it and work it, or they will lose the greater part of their income. Only as plant wears out and expensive renewals become due, will it be worth while in some cases to scrap the capital.

In practice, of course, the rates of profit in any industry will vary widely. Producers in a lightly capitalized industry who by skill, good luck or a favourable situation have been making an exceptionally high profit, will be slow to change. Producers in a heavily capitalized industry, who have been barely able to pay interest on the capital, may not find it worth while to struggle on when an increase in labour costs is added to other adverse factors.

In agriculture or mining the properties that yield a high rent will continue to produce, while those less favourably situated will drop out. The landlord's position is similar to that of the capitalist; it is better that his property should go on being used, so long as it yields any revenue at all. But the rise of wages will obliterate the rent of the marginal land, and the landlord will have no inducement to continue it in use at any rate for the same form of production as before. Nevertheless the same land is adaptable to various uses, and this marginal land may be turned over to some use requiring a smaller amount of labour, e.g., it may be changed from tillage to pasture.

The foregoing discussion relates to a rise of wages above the economic rate in one industry or in a limited selection

of industries. What happens, it may be asked, if wages are raised throughout the entire labour market of one country, so that *all* industries and occupations are affected? We may rule out the case where the universal rise of wages is accompanied by a universal rise of prices, for that means a depreciation of the currency, and the rise of wages would be nominal only. We assume therefore that the foreign exchanges are kept by suitable measures of control (e.g., through a gold standard) at par.

In the first instance there will be a difference in the behaviour of home-trade and foreign-trade industries. Foreign-trade products, competing either with imports or with exports, will be tied to world prices. Home-trade products will be raised in price, slightly in the heavily capitalized industries, substantially in the others.

As some prices rise and none fall, the general level of prices will be somewhat raised. But as there will simultaneously be a curtailment of output, this will not necessarily mean an increase in the aggregate pecuniary income of the community.

This situation will not be one of equilibrium, because the rate of profit will be higher in the home-trade industries than in the foreign-trade. Producers will drop out of the latter class of industry faster than out of the former, and some may even transfer their enterprise from one to the other. The loss of productive power in the foreign trade industries will give rise to an excess of imports, and the consequent adverse tendency in the foreign exchanges must, on our hypothesis, be corrected by a contraction of credit. The contraction, while it is in progress, must aggravate the general tendency to unemployment, but that is a transitional effect, not specifically due to the excessive rate of wages When the contraction is completed, the prices of home-trade products will have been lowered, and the discrepancy between home-trade and foreign-trade industries in respect of profits will have been removed.

Exports will have been restricted to those in which the country's local advantages are sufficient to outweigh the additional cost of labour. The corresponding reduction of imports will have been effected by a curtailment of the spending power of the population. Now the excess of imports to be corrected is due not only to the falling off of exports, but also to the diminished competing power of the home producers in the import markets. These home producers find their costs of production increased, and, as their output falls off, the imports of competing supplies increase The

curtailment of spending power must be great enough to offset the tendency to increased imports.

The curtailment of spending power is secured through the credit contraction, and is applied impartially to all products. The precise extent to which any particular product is affected depends upon the elasticity of demand.

In the case of foreign-trade products prices are governed by world markets; with prices approximately fixed, when spending power contracts, the consumption of those products for which the demand is elastic diminishes most. In the case of home-trade products prices are free to vary. The price of a product for which the demand is inelastic may be forced up owing to the increased costs. On the other hand, where demand is elastic, the price of the product may actually fall despite the increased costs.

On the whole the presumption would seem to be that home-trade production would suffer in the end just as much as foreign-trade production. There would be an all-round shrinkage of output and consequent unemployment.

A protective tariff is sometimes advocated as a defence against the competition of foreign cheap labour. We have already shown in Chapter XXV that a protective tariff raises money wages, and that it may either raise or lower real wages. That process is not materially affected by the existence of underpaid labour in foreign countries. Underpaid labour is not really an appreciable advantage in international competition. The most that a country can do is to produce up to capacity, and it can do that with wages at the economic level (apart, of course, from cyclical unemployment). If labour is under-paid, producers, when they can no longer expand output, ask as high prices as their rivals in other countries, and what the workmen lose goes not to underselling, but to making excessive profits.

If a rise of wages above the economic level be supposed world wide, an excess of imports will not occur. The general rise of costs of production will leave international trade approximately in the same equilibrium as before. But that merely means that the maintenance of the foreign exchanges at par will no longer be a safeguard against a general rise of prices which would nullify the nominal rise of wages. If however, a system of gold reserves be supposed in operation, such as will not allow a permanent increase in the aggregate of money incomes, prices cannot rise unless there is a decrease in production. The increase in costs will render a certain number of productive businesses unremunerative. As they drop out, output will be diminished, and

prices will rise. On this assumption equilibrium will be restored with a certain amount of unemployment and some decline of purchasing power to set against the nominal rise of wages.

The hypothesis of a world-wide rise of wages above the economic rate is in reality an artificial one. Local variations in the economic rate are enormous, and there can be no question of organized labour adopting a uniform international standard.

Something like a world-wide movement occurs when there is a general contraction of credit extending to all gold standard countries. The effect of the contraction is to raise the commodity value of gold, and therefore the purchasing power of all wages fixed in gold currency units. But the unemployment that occurs at such times is by no means wholly due to real wages being above the economic rate. The downward movement of prices, while it is in progress, itself causes a check to enterprise. To counteract this by a reduction of wages, would mean reducing wages *below* the normal economic rate.

One of the principal difficulties in the settlement of wages by any method is the uncertainty as to what the economic rate is. The economic rate must leave a reasonable profit to the producer. But there is no standard of what is a reasonable profit, and even if there were, the profits of producers differ widely. With any rate of wages that could be seriously entertained, it would be found that some producers' profits are above the standard and others below.

Moreover, if wages are so fixed as to afford a reasonable profit, any industry which on account of its inefficiency, obsolescence, unsuitability to the place where it is carried on, or any other reason, is unable to earn a reasonable profit, will be enabled to throw the burden of its defects upon the labour employed in it. If the workmen were alive to their own interests, they ought to forsake the industry in favour of one where wages were normal. But, to do so, they must first be able to estimate what their several grades of skill ought to be worth in other industries, and must then face all the risks and sacrifices involved in a change. Transference is in practice likely to be slow, and might even take several generations.

An alternative to profits as a test might be unemployment. An empirical solution would be to push wages up to the point at which unemployment supervenes, or at any rate threatens, and then stop. If industry were stable, that might be possible. But the gratuitous complications of the trade

cycle here interfere, and all traces of any stable or permanent standard are obliterated by its oscillations. Most of the wage disputes that actually occur arise in the course of the adjustment of wages upwards and downwards to the perpetually changing phases of trade and of prices.

But even if the trade cycle could be eliminated, the empirical determination of the economic rate of wages in each industry would yet be a matter of great difficulty. The adverse consequences of raising wages too high may take a long time to appear. If the excessive wages are confined to certain industries, in which the recruitment of labour is suitably restricted, the adverse consequences will be avoided, or rather, they will be shifted on to the shoulders of those who are outside the favoured circle of industries. If these conditions are regarded as given, the effect is to depress the economic rate of wages in the other industries. In any community in which skilled labour is organized, but unskilled labour is not, the advantages gained by skilled labour may be at the cost of an artificial depression of the standard of living of the unskilled.

If wages are fair relatively to one another, but as a whole, are too high, the unemployment which is the penalty, will, in some industries at any rate, only manifest itself slowly In practice those who have to settle wages, whether by collective bargaining, by arbitration, or by authority, find themselves driven to seek guidance from the very equivocal test of reasonable profits.

A principle very frequently appealed to is that of a living wage. Ricardo took the view that the natural price of labour depends on the price of the food, necessaries and conveniences required for the support of the labourer and his family. He did not mean that wages always tended to a bare subsistence level. His "natural price of labour" included "those comforts which custom renders absolute necessaries."

That is substantially the doctrine of the living wage as it still survives. Ultimately it is no more than an appeal to a standard which has become customary, whether among workmen generally or in a particular trade. It is of some value in the case where the purchasing power of money varies, in that it points to such changes in money wages as will preserve real wages unchanged. But where circumstances require an increase or decrease of real wages, the principle of the living wage gives no guidance, or rather it gives false guidance in that it indicates no change when a change is required.

There is a further complication in all wage disputes, which up to this point we have left on one side. The economic rate of wages is of course a rate of payment for each unit of work done. The rates of wages about which employers and employed negotiate and dispute are sometimes piece-work rates, which conform to this description, but more often they are payments for each unit of time worked A given time rate may cover a variety of rates for work done according to the capacity and the assiduity of the workman. Both the capacity and the assiduity of the workman may be affected by the rate of his remuneration itself. Experience shows that higher pay often improves the efficiency, mental as well as physical, of the workman. A rise of wages, extorted in face of the employers' expectation of imminent ruin, may turn out not to be a rise at all, but merely an increased payment to the workman for an increased output. This is especially so where the rise takes the form of an undiminished weekly payment for a reduced number of hours' work.

Sometimes when the nominal rate of wages remains unchanged, the true rate can be raised above the economic rate by a concerted restriction of output on the part of the men. The effect is to produce the injurious consequences of a visible rise, but with a smaller number of unemployed and no increase in the incomes of those who remain employed.

It is of the essence of a free bargain in a market that either party should be able, if he chooses, to refuse to deal, rather than agree to the offer of the other. It is therefore, of the essence of collective bargaining in the labour market that organized labour should be free to refuse to work rather than accept the wages offered by the employers. If labour were unorganized, any individual workman would, no doubt, be free, if he were dissatisfied with the prevailing rate of wages, to refuse to work except for a higher rate. But so long as there is no concerted refusal, and a great part of the workmen remain at work, the action of the malcontents causes little inconvenience to the employers. The time for which the malcontents can afford to remain unemployed is limited, and when they are at the end of their resources they must return to work on the employers' terms.

For the refusal to work to have any effect, it must be extensive enough to cause embarrassment and loss to the employers. Organized labour, relying on the right to strike, is therefore part of the necessary machinery of the labour market. Without it the individualist system works imperfectly. Even with it, it is true, the system leaves much to be

desired. In case of failure to agree, the stoppage of work, whether strike or lock-out, becomes a trial of endurance between employers and workmen, in which that side wins which can stand its losses longest. If the employers act absolutely together, and care to stand out for a decision, it is almost impossible for the workmen to win. The exhaustion of the workmen's resources is merely a matter of time, and the employers have all the credit attaching to the capital of their business to fall back upon. And if the workmen are defeated in this way, they are left for the time being helpless, for it would take them a long time to accumulate a sufficient reserve to try another strike. It is, therefore, usually futile for the workmen to resort to a strike on any question on which the employers genuinely believe their interests to be seriously threatened. Success can only be hoped for when the employers are divided, or when the concessions sought from them are not so great as clearly to outweigh the loss arising from a strike. Once the stoppage has begun, the tendency is for the workmen to be more willing to compromise as their resources ebb, but for the employers to stiffen, as the further loss remaining for them to go through gets less and less

Why then do workmen ever actually resort to a strike? One reason is that the threat of a strike could never be effective unless it were sometimes carried out. Employers only know by trying how far they can press their workmen without provoking a strike. Workmen only know by trying what concessions the employers would make to escape the loss involved in a strike, and what concessions they would regard as vital. A stoppage is often precipitated by bad leading, or indeed by the inevitable limitations of the leaders on both sides. It is impossible for the leaders to know fully the views of their followers. They may treat as vital an issue upon which compromise would have been possible and is actually arrived at in the course of the dispute.

Nor can the psychological reactions of the dispute itself be disregarded. Success on the part of the employers may be a pyrrhic victory. Embitterment and discontent of the workmen are not in the interests of the industry. The strike imposes heavy sacrifices on the workmen. While the employers face pecuniary loss, the workmen face privation. The sacrifice of the employers is an affair of the balance sheet; if they decide to stand out at the cost of a stoppage of work, that is because they believe that in the long run the gain will outweigh the loss. The sacrifice of the workmen is direct and personal, and claims consideration accordingly as

direct evidence that they care about the matters in dispute. Their cause gains thereby moral power, which influences the employers and incidentally also public opinion.

The strike remains a clumsy and not very effective weapon, even though it be a necessary one, and it is partly a recognition of its shortcomings that has led the labour organizations to seek what they can get from the formation of Parliamentary Labour Parties. A considerable part of those improvements in the conditions of labour, which are sought by trade unions, can be as well or better secured by legislation, without involving the loss and distress inseparable from strikes. The democratic electoral systems which have been established in Europe and in countries of European descent have put organized labour in a position to elect deputies of their own class, who have an understanding of their own problems.

The Parliamentary Labour Movement has yielded a respectable crop of legislative measures. For example, the legal position of trade unions has been safeguarded; employers have been compelled to take precautions against accident or disease to which their workmen are exposed by the nature of the industry; subsidized schemes of insurance against sickness and unemployment have been instituted; hours of work have in some cases been limited, and minimum rates of wages have been prescribed. Such reforms of course are not exclusively due to Labour Parties, but they have derived support from them both in England and in other countries. These measures, though Socialist in tendency, are not inconsistent with the principle of individualism. Like the public regulation or ownership of public utilities, they have been grafted on an individualist system. In a free labour market statutory obligations, in so far as they impose extra outlay upon employers, tend to diminish wages. But the cost of measures which contribute materially to the health, safety or welfare of the work-people may be quite slight, and the statutory requirements may be fully justified if these benefits cannot otherwise be obtained.

Statutory minimum rates of wages are on a different footing. If they are fixed too high, they bring about the injurious consequences already indicated. But it should not be taken for granted that a statutory minimum wage will only be adopted in a vain endeavour to push remuneration above the economic rate. The intention may be to ascertain the economic rate, and to prevent employers from paying less. If it were possible to ascertain the economic rate of wages with any approach to scientific accuracy, this

might be a very great advantage. Unfortunately the problem is far too elusive. Minimum wage legislation sometimes benefits the work-people in industries where they are especially helpless, ignorant and unorganized, and exposed to the exploitation of employers. Comparison with earnings received in uncontrolled industries for services of similar grade affords an independent standard which may be presumed to approximate to the economic rate. But no statutory substitute can be found in the main body of industry at present for the bargaining of the labour market, with all its defects.

The Parliamentary Labour Movement could not fail to become aware of its own limitations, so long as it confines itself to supplementing an individualist system. That is one explanation of its intimate relation to Socialism Socialism, which we shall examine in the next two chapters, represents the revolt of the Labour Movement against these limitations.

Meanwhile there remains what we have called syndicalism. Syndicalism may be interpreted to mean a new form of democratic government based upon vocational organizations, of which the trade union is a type. Taken in that sense, it is an interesting subject of speculation, but we shall not pursue it here. The syndicalism we are concerned with is not a logical structure but rather a *tendency*. It is, as stated at the beginning of this chapter, a tendency to use the trade union weapon of the strike to attain political ends. Without asking for any new constitutional position in law to be given to the vocational organizations, syndicalism claims that the trade unions already possess such power as can make them predominant in the State, if only they choose to use it.

The ultimate basis of this power is the general strike. If all industries simultaneously strike and cease work, it is argued that the community will be paralysed and must submit to do the bidding of whatever organization has the power of ending the strike and restarting economic life. Such a strike is directed not against employers as such, but against consumers. Consumers are dependent upon labour and the general strike is intended to use this dependence as a lever to obtain concessions.

But what concessions? It is not possible to secure the united action of the entire working class except for some cause which they really care about. And if they do care about it, why should they not, in a democratic country, seek it by the ordinary legal method of electing representatives pledged to do what is desired?

It may be admitted that the organization of a political majority is by no means an easy task, and that any alternative form of organization, which is easier to attain, may be worth trying instead. But what can the general strike really accomplish? The consumers upon whom it exerts pressure include all the strikers themselves, and their families Those included outside the ranks of the strikers are to a great extent, well-to-do people, with resources which fit them, far better than the strikers, to resist the pressure. The Government, as representing the community, will wish to mitigate the results of the strike as far as may be possible But if they are disappointed in their endeavours, that need not incline them to capitulate. The chief sufferers by the strike are the strikers themselves, and the strike is likely therefore quickly to break down.

The general strike may be a formidable weapon of revolution or resistance against a non-democratic form of government. It did in fact play a prominent part in the defeat of the Kapp Putsch in Germany in 1920. The constitutional Government in that case was on the side of the strikers, and the problem was how to oust a non-representative rebel government that had seized the reins of power.

In an effectively democratic country a general strike is hardly possible to organize. If syndicalism is a tendency of practical consequence, that is because something short of a general strike will serve its purpose. The general strike is designed to put pressure upon the consumer, by depriving him of products of all kinds. But while it will take him a long time to miss a fresh supply of some products, there are others which he cannot dispense with even for a few days. Of the latter kind especially are the necessary services required for bringing the existing stocks of all sorts of commodities within the consumer's reach. In fact in a modern industrial community a transport strike is practically as effective an instrument for paralysing economic life as a general strike. And it is easier to procure united action on the part of the limited circle of trade unions concerned with railways and other forms of transport than on the part of the entire working class.

But a transport strike is not in itself an expression of solidarity of the entire working class. The transport workers may regard themselves as the champions of the working class, but if so that is a voluntary concession on their part. Their power, such as it is, is their own, and they are free, if they choose, to use it in their own interests

In one respect, however, the power of the transport

trade unions is not independent of the attitude of their neighbours. Every strike is liable to fail if an alternative supply of labour is forthcoming to take the places of the strikers. It is not easy to improvise the working of a railway system with blackleg labour, but still, if a sufficient number of willing workers offer themselves, the essential services can be carried on, and, once started, they grow more efficient with experience.

So deep is the working man's conviction of the value of the right to strike, that a potent taboo has come into being prohibiting blackleg labour. A strike with syndicalist inspiration can count on this taboo apparently no less than an ordinary strike. The transport workmen may strike for some end that concerns themselves alone, with the avowed purpose of obtaining it not by causing loss to their employers, but by making life intolerable for their neighbours. Yet the taboo will be unquestioningly observed by those of their neighbours who are themselves wage-earning workmen, and the task of organizing an emergency transport system will be left to the middle and upper classes, possibly with the aid of military forces.[1]

If syndicalism is a power, despite its apparent futility, that is due to the solidarity of the working classes. And their solidarity is due to a certain community of ideals, which finds its most articulate expression in Socialism.

[1] The use of military forces to break a transport strike, not by the use of force, but by organizing an emergency transport system, is not uncommon, because transport is itself part of the military art. Every army must be able to supply transport in places where none exists or where existing facilities have been destroyed.

CHAPTER XXVIII

COLLECTIVISM

In defining Socialism to be the use of the State as an instrument of welfare we have lapsed from the pure doctrine of the early Socialists. To them Socialism meant the nationalization of the means of production, distribution and exchange. Before considering the weaker compounds which are accepted by compromising spirits of the latter-day Socialist Parties, we will direct our attention to the thorough doctrine of the old school.

Socialism of this type may be distinguished by the name of Collectivism. It is really the same thing as Communism, but Communism has come to be associated with revolutionary violence, and the term is inappropriate in a dispassionate discussion, which is concerned with the state aimed at and not the method of reaching it.

Collectivism is essentially a rejection of the system of private profit. It has to provide somehow for the functions discharged in the society we know by traders who work for profit. In their place it puts functionaries or bodies with authority delegated from the State. It is a solution of the economic problem based upon the authority of the State instead of upon the motives of the market.

The market would not, or would not necessarily, be entirely abolished. Consumers might still be allowed to express their preferences through the prices they would be prepared to pay at the shops. But the markets that intervene between producer and retailer and between producer and producer would vanish. In fact between the worker by hand or brain and the ultimate consumer there would be no other intermediary but the State and its delegates. The wholesale and retail dealers, and the organizers of production and transport would all be replaced by people responsible to the State and remunerated by salary, or at any rate otherwise than by profit.

This suppression of profit would not in itself be incon-

sistent with the existence of private capitalists receiving interest, so long as they could claim nothing more than interest, and could not, in their capacity as capitalists, exercise any power over the enterprises using their capital. Nevertheless the suppression of the private ownership of capital is regarded by most collectivist Socialists as of the essence of their creed.

The State, having taken all profit into its own hands, becomes independent of the services of the private investor, and need not offer him interest. It possesses the resources out of which far the greater part of the accumulation which feeds the investment market comes The chief aim of Socialism is to equalize the people's economic position, not necessarily to establish exact equality of incomes and resources, but to eliminate the causes of those gross inequalities which distinguish the individualist system.

Of these causes interest and rent, though not more potent or fundamental than profit, are more conspicuous. The collectivist, to soften the transition, may allow existing capitalists and landlords to draw their incomes, and may be prepared to continue the same privilege or something less to their children, but he will not consent to perpetuate the system of unearned incomes derived from property.

Thus the State is constituted the sole capitalist and the sole landlord as well as the sole employer. It could be given these functions by legal monopoly, or alternatively private traders working for profit could be tolerated, and the superior economic power of State-managed industry could be relied on to prevent private trade and industry gaining any real footing.

The obvious criticism of the collectivist ideal is that it demands more of the State than any administrative machine yet devised can be relied upon to do. Those Socialists who have kept most clearly in view the embodiment of their ideals in a concrete and practical form have sought to meet this criticism by supplementing the authority of the State with various voluntary or statutory associations, such as associations of work people evolved out of trade unions, or associations of consumers evolved out of co-operative societies. Instead of saddling the State with direct responsibility for an indefinite number of Government enterprises modelled on the Postal Services, the State Railways, the Dockyards, Arsenals, and Mints, with which we are familiar, they would entrust as much as possible of the task to these associations, and to that extent confine the functions of the Government to co-ordinating their activities.

To appreciate the problem, we must consider exactly what the functions are which are discharged by the traders who receive profit, and which would devolve on the State with or without the assistance of the suggested associations. These functions we have already mentioned in earlier chapters. The traders include the organizers of productive enterprises, who determine what kind of fixed capital shall be installed, and how it shall be maintained, renewed or extended, who engage and discharge workmen and exercise discipline over them, and who decide the task to be allotted from time to time to each man. The outcome of these activities is that the producer can supply a given output, when called upon, within the capacity of his business.

The traders also include the dealers in commodities, who hold stocks from which they sell to the consumers (or to other traders), who order goods from the producers to keep up their stocks, and who employ the transport undertakings to carry the goods to the places where they are required.

Partly to producers and partly to dealers falls the duty of *foreseeing* the consumers' requirements, and devising new commodities and services for the consumers' satisfaction. If the trader class is to be swept away, these responsibilities must be assumed by their successors. If we leave out of account for the moment the proposal to bring in associations of producers and consumers to help, and suppose the State itself to do everything through a hierarchy of functionaries, we find the task in some respects simplified by the mere fact of centralization. The State, as the sole trader, has cognisance of the stock of every commodity, of the sales to the consumer, and of the output. The due balance between output and consumption can be tested by the actual facts.

But when the balance is disturbed, the question immediately arises whether it is to be corrected by an adjustment of price or of output. The answer can only be a matter of practical judgment. In an individualist community the action taken is the resultant of many different individual opinions. Each dealer decides for himself at what price it is worth his while to order future supplies. Each producer decides for himself to what limit it is desirable to extend his output, and at what point he shall ask for an increase of price. Each separately is fallible, but individual errors are to a great extent eliminated by the law of averages. The State would be better placed to reach a correct solution than any one trader, provided that the data available to it were properly collected and assembled. But, however perfect the data may be, the solution cannot be purely a

matter of calculation ; it remains a matter of judgment, and subject to error And for want of the saving influence of the law of averages, the judgment of the State though better than that of any one trader would be worse than that of all traders taken together.

Centralization also brings with it peculiar difficulties of organization, in that all the functionaries engaged in the work of dealing in commodities would be acting *under instructions*. The trader working on his own account is responsible to no one. He decides in his own mind what to do, and is not required to explain or to defend the decision to anyone. The directors of public companies are responsible, it is true, to their shareholders, but in practice the shareholders usually ask for no more explanations than the directors offer. And though in many big public companies the directors cannot but hold themselves accountable for everything they do, much as public officials would, yet in many others and in nearly all private companies there are one or two predominant shareholders who exercise substantial control, and either are themselves directors, or are in a position to treat the directors as their servants and agents.

Substitute a functionary for an independent trader, and he finds himself precluded from doing anything which he cannot explain and defend, if called upon, to his official superior. His tenure of his office and his chances of promotion depend upon his efficiency and success, and his efficiency and success can only be judged from what is recorded of his activities.

His position is well illustrated by his accountability in matters of money and property. One who is dealing with his own possessions, can exercise a free discretion in making judicious concessions to individuals, in taking risks of loss, in selling off stocks at a sacrifice, in compromising liabilities, and in many similar operations. To a public official dealing with public property such freedom is impossible. It is not sufficient to rely on the personal honesty of the individual, and to accept the risk of loss in the exceptional cases of dishonesty. For if the ordinary precautions of accountability are relaxed, the opportunity of lucrative peculation will attract dishonest people into the service, and no safeguard can be devised to keep them out. Public employees would thus become *below* the average level of probity.

Pecuniary accountability is unavoidable, and it is only a part of the restraint to which those who work with delegated authority are subject. The injurious consequences

of such restraint proceed from human nature itself. The practical judgment is partly sub-conscious, and, in so far as it is conscious, its mental processes are not *linguistic.* To express in language even the decision itself is an effort; to express the grounds on which it is taken would often be a formidable exercise in both psychology and literary composition. And when it has been done with the highest skill and sincerity, the result would probably be only a partial and inaccurate account at the best. This is true not merely of the grave decisions upon which far-reaching consequences depend, but of the trifling decisions taken by average men every day. There is a tendency for any official hierarchy to be limited to those decisions that can be readily communicated in language from one functionary to another. Much has to be done by printed regulations of general application. The drawbacks of official procedure are becoming familiar in the conduct of industry under the Communist régime in Russia. An enlightened bureaucracy would try by every available means to escape from this paralysing limitation, and to devolve and decentralize wherever possible. But the limitation is inherent in the system, and cannot be avoided altogether.

The disadvantages of official direction do not arise to an equal degree in all cases. For some kinds of business it is found to work easily and well. We have already seen how circumstances have placed public utilities in many cases in Government hands. Official direction is not ill-adapted to such services as the transportation of goods, messages and passengers, or the supply of water, light, power, or drainage. Delegation of authority and management by regulation must in any case figure prominently in the organization of a big railway or postal service. The limitations are the same, whether the authority delegated comes from the State or from a body of shareholders. This is to some extent true of all big productive enterprises, where the product to be supplied can be definitely and accurately specified. In those cases where Government production has gone beyond the class of public utilities, it has achieved a very passable success, for example in the construction of war vessels and artillery, the manufacture of military clothing, or the minting of coins.

In cases where the specification and grading of the product are matters rather of judgment than of rule, Government production is at a more serious disadvantage. This is because the problem ceases to be one of production only and becomes one of marketing. The question is how far the

product suits the purchaser, who may be either an ultimate consumer or the producer carrying out a further stage of manufacture.

We will look at the latter first. In an individualist system the producer is interested in buying cheap and good materials, because they enable him to turn out a good finished product at a low cost, and so to secure a high profit. In a collectivist system the producer will have a just cause of complaint if he is supplied with defective materials. But if he is either to refuse to accept them, or, having accepted them, to excuse the consequent defects in his own products, he must be able to state his criticisms of the materials in a definite form. The grading of the materials by an independent inspector before they pass into use is not a solution, for we are here concerned with the case in which the qualities of materials are too various and too individual to be regularly graded.[1] Under collectivist conditions, therefore, the selection of materials of these kinds by producers is likely to be less perfectly done than in an individualist system, where every producer can offer what price he pleases for any materials on offer in the market, that suit his purpose. That means a lower standard of product, and at the end of the productive process a lower standard of finished product for sale to the consumer.

We turn next to the finished product. The consumer's satisfaction, expressed in his willingness to buy, is to the individualist the ultimate test of value. If the consumer does not like one make he will choose another ; if he cannot get what he wants at one shop, he will go to another. How imperfectly the selection works we have seen. It requires more initiative and discrimination from the consumer than he can give. Dealers play upon his weaknesses, and make him think he wants things that he does not want, or sell him things which are not what they appear to be.

If a collectivist State is going to be guided by sales in the retail market, it will be accepting the same test of value as individualism. Whether it will make a greater success of it is open to doubt. On the one hand the State-employed shopkeepers will have less inducement to exploit and deceive their customers. But on the other the customers will have less power to make their preferences felt. If a customer is dissatisfied with one article, the shopkeeper has no motive except a sense of duty to show him alternatives, or to tell

[1] Wool is sold by auction because, unlike cotton, it cannot be systematically graded. But the difficulty of grading arises more generally with half-finished products than with the great staple materials.

him where they can be got. The efficient and public-spirited shopkeeper will attract custom and be overworked; his stupid or lazy colleague receiving the same salary in a neighbouring shop will have an easy time. When there is competition among producers, the sales of the finished products are some test of the consumers' satisfaction. When there is only one producer, the consumers have to be content with what he produces; if they are dissatisfied they have no remedy except through complaints. Complaints must *formulate* the grounds of dissatisfaction, and here again we find the same fault inherent in a big organization—the judgment of the individual is ineffective unless he can express it in words and communicate it to the responsible authorities

The collectivist State retains two markets. At one end is the retail market, at the other the labour market. But both markets are profoundly modified by the fact that in the one the State is the only seller, in the other the State is the only buyer. The settlement of wages is theoretically facilitated by this circumstance. The problem of what is a reasonable profit does not arise, because profit does not have to be held out as an inducement to anybody. The State is in a position to view the problem as a whole. By keeping cost accounts the governing authorities can ascertain what profit, if any, is being realized on any branch of production, but they are not obliged to be guided by the amount of profit, and so long as the economic business of the State as a whole is solvent, there is no need for each separate part of it to be so. It may still be desirable to pay extra for skill, for ability and for the fruits of training, and to attract recruits into the occupations where they are needed by the offer of better remuneration. But this would not be the sole means of regulating the flow of labour, since it would always be for the State to decide how many are to be taken into employment in each industry

This freedom to determine wages, while it has the appearance of being a great advantage, is in reality a source of difficulty and perplexity. The monopolist State is constituted arbiter of the destiny of the entire working population, and there is no set of principles that can give it unequivocal guidance in using this power.

It might indeed adopt the policy of relating cost of production to selling price in every industry on the same lines as in an individualist society, securing for public purposes an approximately uniform rate of profit on output. But that is not by itself a solution, for the State itself determines selling price, and output, on which selling price depends

Any group of workmen, thinking that their skill deserves a higher rate of remuneration, could urge an increase in selling price if necessary to provide the additional funds. The rise in price might mean a reduction of sales and therefore of output, but then the State can bring about a reduction in the number of workmen by cutting off the supply of fresh recruits for a time, and possibly drafting some of the less efficient of those already employed into other occupations

The sign that an industry is too much favoured would be that employment in it was specially sought after. But that test is not easily applied. The attractiveness of a post is not necessarily measured by the numbers applying for it. The candidates are limited to those who think they have some chance of success. The excess of competition for the post will make itself felt not so much in a large number of applicants as in an unnecessarily high standard of qualification But who is to say that the standard is too high ? The best judges will probably be those employed in the industry Even without the promptings of any definite self-interest, they may be led by zeal and craft-pride to insist on a high standard But the State has to arbitrate among the rival claims of all industries, each desiring the highest remuneration that they can make out a case for.

The difficulty is a serious one, and goes to the very root of the principle of a collectivist State. The experience of Government enterprises in individualist communities does not help towards a solution, because they are surrounded by free labour markets, in which appropriate rates of wages are determined for every grade of labour. And in fact, in spite of this, Governments often encounter very embarrassing claims from their employees, which force up the costs of public enterprises above the normal level. These claims are reinforced by political pressure, and the danger of such pressure in a collectivist State administered by a Parliamentary Government is obvious. There is some tendency among Socialists to dissociate collectivist Socialism from this form of Government Communism as a political force at the present day is emphatically hostile to Parliamentary Government Exactly what the Communists would put in its place is not very clear. A " dictatorship of the proletariat " is not very different from democracy, at any rate in a fully developed collectivist society, from which the trader and the rentier have been eliminated. The question is through what organs the proletariat is to exercise its power. A " vocational Parliament " in which deputies represent industries instead of geographical constituencies, may have advantages and

disadvantages, and would certainly differ in many practical respects from the Parliaments we know, but it does not mean any fundamental change of principle.

As Mr. Bertrand Russell has said, the Soviet System in Russia is a dictatorship not of the proletariat, but of the Communist Party. Russia used to be governed by those who believed in monarchy; now it is governed by those who believe in Communism. But this is not a system of government. A party striving to establish and maintain its principles will organize itself and put leaders in authority. But the leaders' authority arises out of the conflict. Let the principles once definitely prevail, and the party loses the reason of its being. The leaders can no longer appeal to the loyalty of followers ardently desirous of supporting the party principles; the foundation of their authority has gone, and at that stage a legally established constitution becomes necessary.

In reality there is no serious competitor with representative Government as the organ of democracy. To examine the proposals that have been made to adapt representative Government to a Socialist State would carry this digression too far afield.

Let us return to the question of wages. A collectivist State will presumably carry on some foreign trade. Will not foreign standards of wages and of costs of production supply an independent test of remuneration, at any rate in foreign-trade industries? The State is the sole exporter and the sole importer. In both capacities it will have constantly to measure the prices prevailing in foreign markets against its own costs of production, and prices. It will buy in foreign markets in order to give its own consumers cheaper and more plentiful supplies of certain things than could be provided at home. It will sell in foreign markets, because that is a condition of buying. So long as some foreign countries with which it does a substantial amount of trade adhere to an individualist system, the collectivist State can derive from them a standard of comparison for prices and therefore for costs of production. The Government can fairly stipulate that in the industries which compete in the export and import markets wages shall not be so high as to upset the balance of exports and imports. But still the Government retains its fatal freedom to fix supplies and prices. It can limit imports as it pleases; it can sell exports at a loss as it pleases. It may prefer to make foreign trade self-supporting, but that is a decision which it can be compelled by popular pressure to modify.

Another possible wage-policy is to aim at the nearest practicable approach to *equality* of remuneration for all occupations. This was the pristine Socialist ideal. Everyone ought to contribute what effort he can to the common good. Whether the result be great or small, if he has done his best he deserves his reward. A slight discrimination may be unavoidable in favour of those occupations which are especially unpleasant, or laborious or difficult, but it should be severely limited to that which is absolutely necessary to secure enough candidates for employment. It is said that when the Russian Communist authorities at Moscow proposed to pay their greatest opera singer the same remuneration as the doorkeeper, he said he would serve as doorkeeper. Nevertheless, where equality is the rule, a slight additional remuneration may be sufficient to attract candidates to the most skilled occupations.

This is perhaps the most hopeful solution of the problem of wages. Still it does not escape altogether the danger that the rate of remuneration in a particular occupation may be forced up by insisting on an excessively high standard of qualification. If occupations necessary to the community got into the hands of powerful trade unions, their remuneration might be so raised that the principle of equality would be destroyed.

There is another question, closely related to that of wages, which confronts the collectivist State. That is the provision of fixed capital. In the individualist State the greater part of the resources available for investment are derived from profits. In the collectivist State the whole must be provided by the Government. So far as investment at home is concerned, the Government will employ and pay a certain amount of labour in the constructive industries. The plant and other products resulting will be the property of the Government. The people employed will spend their money upon *consumable* goods, the products of other industries. The prices of consumable goods must be so determined that they exceed cost of production by such an amount as shall in the aggregate provide the Government with the funds for paying all those who are employed for any other purpose than the production of consumable goods. In other words Government must make a sufficient profit to meet its overhead charges, and the maintenance, renewal and extension of its capital. (The profit might be given the form of taxation, but in a collectivist society that makes little material difference.)

To put the same thing in another way, the incomes of

the community are spent on consumable goods, and the prices of the consumable goods must be so fixed that over any considerable period the *whole* of the incomes are used up in buying them, though a part only are derived from producing them.

If wages are fixed too high relatively to prices, the margin available for capital outlay is diminished. There is a conflict between the pressure for high wages, and the claims of capital development in the interest of the future well-being of the community. Critics of Socialism sometimes jump to the conclusion that in this conflict the immediate claims of the wage-earners would prevail, and capital extensions, perhaps even renewals and maintenance, would not be adequately provided for. That is one of the dangers to be taken into account, but it is not right to take the improvidence of the collectivist community for granted. Workmen do not care to be set to work with defective plant, and they are likely in most industries to insist on adequate maintenance and renewals. Extensions are almost unavoidable, when an increase in the number of people of employable age makes itself felt. Moreover the workmen in the constructive industries must be provided for. A reduction in capital extensions is contrary to their interests.[1] Thus reasonable prudence will be reinforced by pressure from powerful sectional interests

It is not to be inferred that the danger of inadequate provision for new capital is non existent One form it might take is an encroachment on the supply of circulating capital, that is to say, stocks of commodities. If the total money income of the consumers is increased, so that it exceeds the total money value of the output of consumable goods at the prevailing prices, then, unless prices are raised, the spending of the consumers' income will diminish stocks by more than the amount of replenishment from fresh production. If prices are raised, then real wages are thereby reduced, and the apparent increase becomes no more than a monetary disturbance. If prices are not raised, the depletion of stocks of commodities will persist, till eventually queues will form, and rationing will become necessary. There may then be a tendency to divert productive power from capital goods to consumable goods, in order to escape from the dilemma of high prices on the one hand and rationing on the other.

[1] At the present time the under-employment of the heavy industries in Russia is a consequence of the shortage of resources available in the hands of the Soviet Government for capital outlay.

The adoption of collectivism by a country which exports capital raises some interesting questions. If the export of capital is to continue, it must be in the hands of the collectivist Government, which must ensure to itself the requisite resources by maintaining a sufficient margin between the prices of the things it sells at home and their costs of production. However strong the motives may be for maintaining the supply of capital at home, it seems very doubtful whether the population of a democratically governed State would consent to be subjected to pecuniary sacrifices for the development of foreign countries, even if the capital so invested is expected to yield good interest later on. Yet if the adoption of Socialism in the more fully developed countries meant an interruption of the development of the new countries, that would be at least a serious drawback from the standpoint of the interests of the human race as a whole.

All the foregoing criticisms, it will be recollected, are directed against the simple form of collectivism by nationalization undiluted. Nationalization as now advocated is usually modified in certain respects, particularly by the introduction of associations of workers and of consumers. These associations, like elective local authorities, are independent organs of democracy. Their authority is not derived from the Government of the country (though it may be recognized and delimited by law) but comes from the individuals who form the associations.

We will now proceed to consider the part they might play in a collectivist State, and first we will take the associations of consumers. Such associations already exist in the shape of co-operative societies. They could be extended without any fresh legislation, and, if consumers generally cared to join them, they might to a very great extent displace the trading dealer in commodities. Without assuming any such natural extension, we may suppose that a collectivist State could without serious difficulty create associations of consumers with an absolute monopoly or at any rate a virtual monopoly of the business of retailing.[1]

Each association would secure the trade goodwill constituted by its own membership. Presumably the associations would be mutually exclusive, that is to say there would never be two dealing in the same commodity in the same place. Even if this were not so, it would not be in the spirit of Socialism to rely upon their competition with one another

[1] The experiment of creating a monopoly in favour of the co-operative societies in Communist Russia broke down, partly from want of capital partly from insufficient technical capacity.

as a means of securing good service. Rather the managers and staff of the shops and other establishments run by each association would be responsible to the members. The co-operative system does not escape the disadvantage of the consumer having to make his views known through an organization, instead of rewarding with his custom the trader who gives him what he wants. It puts on the consumers, or at any rate on their representatives, the responsibility for *originating* things. Traders, it may be admitted, do not discharge this responsibility in an ideally satisfactory way. But their shortcomings are partly due to the want of imagination that is inherent in human nature, and partly to the inertia of the consumers themselves.

If the consumers give a free hand to their managers, the managers may do as well as the private traders. There is no particular reason why they should do better ; so long as they show enough zeal and efficiency to keep their place, they have no pecuniary inducement to start innovations or take risks, but public spirit and enthusiasm may do as much as a pecuniary inducement.

But the managers labour under the disadvantage that they have not the same ready means as private traders of testing the consumers' preferences. They hardly know whether they are satisfying their customers or not. It is hoped, perhaps, that the members of a co-operative society will themselves take an interest in its affairs, and will offer not merely complaints but criticisms and constructive suggestions. But this is to ask of the members (who are, in fact, everybody) that they should take upon themselves a part of the trader's functions. They have their own occupations and interests, and even if they have the capacity to make useful suggestions, they can only apply it at the cost of time and effort. To bring democratic organizations into the regulation of current affairs is to depart in some degree from the division of labour. In politics the wide field of non-controversial administration is bordered by a fringe of controversy. To the settlement of the questions contained in this fringe a great deal of heat and energy are devoted in the first place by the Parliamentary representatives, and at election times by their electors. So long as the representatives and the electors have nothing more to do than to decide these questions of controversy, their task is manageable, and the encroachment on the time of the electors is small. If they had to keep in touch with the entire field of administration and legislation, every elector would become a whole-time politician. In the same way if every member of a co-operative

society had to help effectively in regulating its affairs, he would have to be a whole-time trader.

Those who construct ideal States are rather prone to assume that the transaction of the practical affairs, political social and economic, of their utopias would be an entirely suitable and desirable occupation for the leisure of the inhabitants. This is a mistake. The main part of public affairs ought to be entrusted to specialists. Some control must be allowed to the people, in order that the policy followed by the specialists may conform to public opinion. But the exercise of this control ought not to require much time or hard work from the ordinary man. To some people public affairs, and particularly politics, supply a very attractive intellectual study, and to others they afford the amusement of a sport. But outside such special tastes time given to public affairs beyond what is really necessary is time wasted. When a question has to be decided, to make a million people participate in the decision instead of one is to multiply the work of deciding by a million.

Trade is an even less inspiring study than politics, and to require the public generally to participate in it would be a most undesirable encroachment on their leisure.

This is not to say that the proposal to entrust the business of retailing exclusively to co-operative societies is unworkable or on the whole bad. All human institutions have their defects. As compared with a centralized collectivist State, the distribution of the responsibility of retailing among a large number of local bodies of manageable dimensions is a great gain. If the disadvantages of delegated authority still remain in some degree, they are at any rate diminished. It may be that the profit-earning trader renders some services that cannot be so readily obtained from a salaried manager, but he has to be paid a high price for them, not only in profits which, for the successful trader, far exceed a reasonable salary, but also in the wasteful duplication of effort involved in competition.

A co-operative society is not a good agency for starting desirable innovations and experiments. But in any case that function does not devolve exclusively on the retail dealer. The retail dealer can only sell what the producer and the wholesale dealer can supply. When he sees an opening for a novelty, he can ask them to supply the article desired according to his specification. But quite as often the first move is taken by a wholesale dealer or producer, who devises new products, and then asks the retailers to stock them.

In a collectivist State a great part of the wholesale dealing

must be in the hands of nation-wide authorities. They must furnish the link between the localized retailing organizations, and the producing organizations which will be concentrated in the places respectively most suitable for each industry.

That brings us to the question of associations of workers. It is in some respects very different from that of the associations of consumers. The association of workers would in certain respects take the place of the existing trading and profit-earning producers, but not in all. If there were to be many independent associations in each industry, competing with one another, they could perhaps be entrusted with all the functions of the trading producers, hiring land and capital from the State (or possibly from local authorities).

But independence and competition on these lines would not be compatible with Socialist principles. For the remuneration of the workman would be dependent on the fortunes of the enterprise in which he worked. If it were exceptionally successful, he would get more than his fellow workmen in other works. If it failed, he would get less than a fair wage. The fact that he shared responsibility for management would be no justification for these differences. It is a workman's business to do his own work; he cannot be blamed if he fails to exercise infallible discrimination in selecting expert managers, or in criticizing the operations of those selected. And the wisest of workmen may have been over-ruled by his fellows.

If the association is co-extensive with the industry, it is still undesirable to make the workman's remuneration immediately dependent upon profit. Therefore the financial responsibility of the industry must not be placed upon the association, but upon the State. It could hardly be otherwise. The State, as the sole capitalist, places the means of production, land, plant and materials, at the disposal of the association. The association cannot discharge its responsibilities merely by paying rent or interest. The State relies upon it to make proper use of the means of production, that is, to produce an adequate output. Whoever controls output controls price. The State cannot possibly surrender its control over output and price to a monopolist association. It must retain this control and with it absolute authority over the financial fortunes of the industry.

Consequently the intervention of associations of workers does not relieve the Government of its embarrassments in the fixing of wages. It does not really make any difference, because there are bound in any case to be trade unions to bargain with.

What then is left for the associations to do ? It is hardly possible to give them unrestrained power over any part of the business of production. Everything, hours of labour, discipline, promotion, the engagement and discharge of men, conditions of employment, must affect output and costs. The association may have its say in these matters, but only by agreement with the State ; it will be nothing more than a trade union engaged in collective bargaining with the employer. The State may perhaps allow associations of workmen much more say than the private employer ; it may be judged worth while to do so even at the cost of some sacrifice of output or increase of cost. Some matters, such as hours of labour, would have to be dealt with on broad general principles, calculated to secure not identity but substantial equivalence of conditions in all occupations. Others, such as discipline, promotion, engagement and discharge of men, could be dealt with in each factory or other unit by itself, subject only to general control by public authorities.

It will be seen that associations of workmen cannot do nearly so much as associations of consumers to lighten the administrative burden of the collectivist State. Moreover, the power that they have against the private employer they retain against the State. They can strike, if they are dissatisfied with the terms offered them by the Government, and a strike against a Government inevitably takes on a syndicalist colour. It is, in fact, a modified form of civil war. The strikers, by withholding the product for which their labour is required, seek to inflict injury on the community. If the injury is great enough, they win. Syndicalism is a serious enough threat to the welfare of an individualist State ; to a collectivist State it may well be fatal. The only remedy (apart from the growth of an idyllic unselfishness among the workpeople) would be a complete reversal of the existing taboo against blacklegging. If strike-breaking came to be regarded as one of the most meritorious of public services, a collectivist State might survive.

The power of the trade union over output is even more insidious. If the workmen in any industry adopt a standard rate of output per head, it is difficult for any outside authority to dispute its reasonableness, and still more difficult to make them produce more In the collectivist State every workman must have a reasonable wage. If the industry is being carried on at a loss, that does not prove that the output per head is inadequate ; there is always the alternative that the selling price is too low, and the aggregate output ought to be

diminished so that the price may be raised. There then arise all the questions we have already referred to in connection with the fixing of wages.[1]

Our conclusion is that the collectivist Government cannot divest itself of the main part of its burden. Upon it rest all the fundamental decisions, respecting output and stocks, prices and wages. If a new product is to be supplied, the Government must take the initiative in setting up the necessary fixed capital, securing the necessary labour, and organizing the whole enterprise. In arriving at its decisions, it has at its disposal all the expert opinion in the country, but that only means that it can be properly equipped for the purpose. The responsibility remains, and the need for an organization which will choose the experts and ensure their being consulted and given the right opportunities to contribute their advice.

The use of expert opinion is one of the most difficult problems of government. Decisions of policy cannot be entrusted to an expert, for they invariably involve considerations outside his subject. To decide among all possible uses, old and new, to which the productive power of the country may at any time be applied, the Government must obtain the opinions of a great number of experts, and somehow find a basis of comparison and preference among them.

It is no wonder that idealists, who would gladly employ this potent instrument of the collectivist State to improve the world, fear that it would break under the strain of its own weight. *Corruptio optimi pessima.*

[1] In Communist Russia the problem of trade unionism has been avoided, because the leaders of the trade unions are always members of the Communist Party, and their allegiance to the party outweighs all other obligations.

CHAPTER XXIX

NATIONALIZATION

IF we extend the meaning of Socialism to cover the use of the State as an instrument of welfare, in contradistinction to its use as an instrument of organized force, we must take account of a great variety of functions of Government, which conform to this description, but fall short of complete collectivism. Such functions may be advocated as a measure of transition toward collectivism, and they must then stand or fall by the merits of collectivism itself, and by their suitability for making the transition smooth and effective.

But they may also be advocated as beneficial in themselves, and they must then be criticized as modifications of a society which still remains predominantly individualist. We have already given some examination, in Chapter XII, to State enterprises of this character. Our attention was then chiefly directed to public utilities, a certain degree of public control of which is unavoidable. It is not necessary to travel over that ground again.

In the same chapter we also mentioned, but did not discuss a number of services rendered by the State for the purpose of levelling up the standard of welfare, where the effective demand from the individual cannot accomplish what is thought desirable.

The most elementary of all those services is poor relief. Individualism makes subsistence depend upon markets. He who has nothing to sell but his own labour is dependent for his subsistence on the labour market. If at any time for any reason his power of selling his labour is interrupted, and if his accumulated resources are exhausted, he and his family are threatened with starvation.

Whether there are any people so incapable of good and so addicted to evil that they ought to be put to death, by starvation or otherwise, is a question open to discussion. At the present day so strong is the taboo which guards the sanctity of human life, that the death penalty is not inflicted

in civilized countries, except for murder, or for offences against the taboos of patriotism. But in any case the failure of a workman to market his labour on terms which will afford him a subsistence, even if he is himself to blame, is certainly not a fault deserving such a penalty. Work is really only a small part of life. It is, no doubt, a necessary evil, and some pressure ought to be put on every capable person to do his share. But the intensity of the pressure ought not to be out of proportion to the end to be attained.

The problem of poor relief is the problem of the intensity of this pressure. It is beyond controversy that a bare subsistence should be available to everyone at the public expense. Individualist principles demand that no more than a bare subsistence be given, or at any rate that the difference between what is given and what the recipient might get from the market by working should be so great as to be highly deterrent upon idleness. It is sometimes further contended that the difference should be deterrent not only upon idleness but also upon improvidence, that, even when the idleness is involuntary, the relief should be restricted in order that those who are dependent upon their labour should have an inducement to save.

The general tendency of socialistic doctrine has been to narrow the field of deterrent poor relief. This can be done by providing independently of the poor law for as many as possible of the contingencies which may incapacitate a man from earning his living. Much was formerly done, especially in England, on a voluntary basis, by Friendly Societies and Trade Unions, without any Government support, beyond the essential supervision required to prevent abuses. A further development was originated in Germany with the compulsory insurance of workmen against sickness and disablement, the funds being supplied partly by deductions from wages,[1] and partly by a contribution from the State at the expense of the taxpayers.

This system has been widely imitated and extended, and here again England has been particularly prominent. Compulsory insurance has been applied to the provision not only of sick pay and disablement pay, and of medical atten-

[1] Ostensibly there is a joint contribution by the employer and the workman, the workman's share only being deducted from wages. The employer's share is, of course, simply an addition to his wages bill; the economic rate of wages remains what it was, and the employer's share falls on the workman just as much as the rest. The transparent device by which the employer appears to share the cost has nevertheless been imitated in England and elsewhere.

dance, but also of unemployment pay. Old Age Pensions have been provided at the sole cost of the public revenue.

The rates of payment provided for in all these schemes are far below the full wages received by a workman when in work. They may enable one who has no dependants, and who can live with relations, to make a contribution for his keep and to avoid being a serious burden upon them. Such payments may also enable a man who has to maintain an independent household to eke out his savings, and any casual receipts he may obtain, for a longer period than would otherwise be possible. But the class of cases covered by the schemes are not wholly withdrawn from the need for poor relief.

It is open to question whether, if the benefit granted were equal to full wages, the schemes would not break down. The receipt of benefit has to be made dependent on certain tests, in the case of health insurance, upon a medical certificate, in the case of unemployment insurance, registration at an employment exchange and readiness to accept suitable employment when offered. It is possible that, if a workman lost nothing at all by being idle, these safeguards would prove insufficient to prevent abuses.

On the other hand the tests themselves, so long as they are effectively enforced, play an important part in distinguishing cases where the loss of earnings is due to certain assignable causes not within the voluntary control of the workman. That facilitates a softening of the administration of the poor law when it has to be called in aid, though it does not entirely dispense with enquiry into individual circumstances.

But however far the method of separate provision, by insurance or otherwise, against particular causes of loss of earning power may be carried, there cannot fail to be a residuum of cases that cannot be classified. Destitution as a claim to relief cannot be altogether eliminated. Those who cannot support themselves for want of skill, or because they have chosen a trade which does not suit their faculties, may be helped by technical training. But there will be some who from peculiarities of temperament (not necessarily faults) cannot be made to fit into the world of markets. Often they will subsist on charity, on casual windfalls, or on the help of friends, but in the last resort they must be able to claim relief.

If the sphere of poor relief is restricted in this way to a small residuum of unclassifiables, it probably should remain deterrent. The alternative would be to attempt to deal with

such cases in a really discriminating way. That would be a highly skilled task, and perhaps one better discharged by private individuals who come in personal contact with the people concerned than by a Government organization. It may be pointed out that the problem of unclassifiable or half voluntary idleness is one which no amount of Socialism can escape.

The individualist wants a poor law that will be deterrent upon improvidence. If schemes are set on foot to provide for all contingencies likely to cause loss of earning power, will not the inducement to thrift be diminished? The Socialist might answer that the *need* for thrift is diminished as much as the inducement. Compulsory insurance, in fact, is compulsory thrift, and the workman need not be thrifty twice over. And in reality the objection is based on a superficial view of the motives of thrift. It is all the more worth while to have a sum laid by if it is not liable to be dissipated by a period of unemployment or illness If destitution is a condition of relief, the sufferer must use up all his savings before he can claim any help.

State-aided education raises quite different questions from those of poor relief and of insurance against interruption of earnings. Education is a product for which the demand emanates not in general from the individual but from the family. The parents require education for the children, and it is the interests of the children that depend upon the wisdom and capacity of the parents in exercising this demand. Here the individualists' presumption, that every consumer knows his own good best, breaks down, for it is not his own good that the purchaser of education is seeking.

That by itself would not necessarily be a good ground for the intervention of the State. But education is a matter of transcendent importance to the community. It is so, whether judged from the standpoint of welfare or from that of national power. Whatever statesmanship wants the future citizen to do, he is likely to do it better if his faculties have been properly developed in childhood.

It is not merely in regard to the nature of the education to be given, but in regard to its extent that the State interferes. If the resources of a parent are too slender to procure a suitable education for his children at open market rates, the State supplies it to him below cost or even free. Nor is the State content merely to offer this service free; it is regarded as essential in a modern civilized community that education should be not merely free but universal and compulsory—compulsory, that is, upon all families which cannot

show themselves to be able to provide it up to a prescribed standard on their own account.

In Mediæval Christendom education was in the hands of the Church. The clergy were an aristocracy of culture; they maintained an intellectual tradition, and imparted education outside their own circle only to a very limited class. The proletariat had no education beyond the primitive traditions that passed from parent to child. The State's responsibility for education grew out of the decay of this ecclesiastical tradition. The equalitarian tendencies that developed after the French Revolution, together with the growing respect for intellectual enlightenment, led to the gradual acceptance of the policy of universal free compulsory education.

A system of education leads up to a finished human being, not to a perfect human being, but to an ideal conditioned by the qualities and limitations of the material to be worked upon. Unlike Mediæval Christendom, the 19th century State had no such ideal. It carried on, extended and intensified the educational processes which it found already customary; and was far from realizing the vast power which it had taken into its own hands.

In practice this power is circumscribed in two respects, first that the earliest and most impressionable years of the children have already received the influence of the parents before the State organization has begun its work, and secondly that the State can only act through a staff of teachers who have been brought up in the existing educational tradition.

If those who exercise the authority of Government seek to modify the educational tradition, they can do but little by issuing codes of instructions for the guidance of the teachers. Such codes are subject to all the essential limitations of the system of directing human action by the written word. Even if the instructions adequately express the intentions of those who issue them, and are understood by those who receive them, their effect is still limited by what the teachers are competent to do. They can only teach what they know, by the methods they know.

Steps beyond these limits can only be taken by the gradual process of training fresh supplies of teachers. The State's power over educational policy is to be found more in its control over the education and training of teachers than at any other point.

Three separate aims of education can be distinguished: (1) fitness for a trade or occupation; (2) conformity to the

requirements of social life; (3) development of the tastes, faculties and capacities in which the individual's own welfare consists.

Of these three the first is an intermediate product. The preliminary training is a part of the occupation, it is a kind of capital outlay. Its claims to be regarded as part of education would be doubtful, but that it overlaps the other two. Much training that is ostensibly technical is useful in other directions, and much that is purely educational is incidentally of advantage in practical occupations.

The second aim includes the whole realm of manners and morals, and also the formation of political aptitudes. Both habit and will have to be trained to conformity with social rules. Much of what is required is done by way of the inculcation of taboos.

The third aim is concerned with the formation of those tastes and aptitudes out of which the enjoyment of life proceeds. Not only artistic appreciation and intellectual interests, but sport, amusement, conversation can be cultivated. Incidentally it develops the individual as a consumer, but that is only one part of its application.

This third aim is apt to be neglected by statesmanship of a mercantilist inspiration, which seeks to develop the qualities appropriate to devoted and patriotic members of a wealthy and powerful state. The first and second aims also are much more easily made the subject of general rules administered through a rigidly centralized system of public education. The third, on the contrary, will depend on the free play of the individual discretion of teachers, and of those under whose immediate direction they work. The policy of decentralization which has recently prevailed in some countries is partly due to a recognition of this. In England the control of education has been devolved to a very great extent upon local authorities, in the hope that some among them may be found to experiment and originate.

Education suffers, in much the same way as other products, from the want of imagination so characteristic of humanity. The governmental organizations which assume the responsibility for it are not in general inferior in this respect to the consumers who create the demand for any product in a market, or to the producers and dealers who furnish the supply. And there is a very significant difference in favour of the governmental organizations. When new ideas are evolved, the ordinary producer for profit takes no account of them except in so far as he thinks that they can be made immediately attractive to the consumer He is always

circumscribed by the consumers' inertia. A public authority is, to some extent, free to disregard the consumers' inertia, and to decide on innovations from a public-spirited standpoint.

This power has its dangers. Education, like everything human, must take account of our prevailing poverty of imagination. Imagination cannot be imparted from above, or regulated by method. Appreciation, sensibility, receptivity, understanding can be cultivated, and through them material can be supplied for the imagination to work upon. But the active principle in which the imagination consists cannot itself be forced or even trained. All that education can do for it is to see that it is neither starved nor choked and obstructed. From imagination, taken in the wide sense of the power of originating ideas, comes all progress, artistic, intellectual and practical. It is the fertilizing principle in the human spirit.

A public authority is tempted to use its power to impose ideas. This tendency is seen in its crudest form in the teaching of an established religion. In Mediæval Christendom the problem of what was the right religion appeared to have been solved. Heretics who infringed its taboos were punished. Nowadays the multiplicity of religions has, ostensibly at any rate, led to religious persecution being discountenanced. The conflict has been transferred to the question of giving a preference to particular forms of religious teaching through public education.

But the danger of State-imposed ideas is not limited to religion. Public authorities, more especially under democratic institutions, have an undesirable propensity always to prefer *unobjectionable* ideas. That propensity, if not counteracted, may have a fatally deadening effect upon culture. Nor is its influence only negative. An evil tradition, once started, may be confirmed through its blind acceptance by public authorities. How much of the tremendous power of militarism and imperialism on the continent of Europe in the period before 1914 was due to the authoritative dissemination of the teaching of patriotism !

The responsibilities of the State and public authorities for education do not stop short at the establishment of a teaching organization. Museums, libraries and picture galleries are everywhere made a public charge. Intellectual activities are endowed. Assistance is given to research, scientific, historical and archæological. In some countries there is subsidized drama or opera.

But to class these as purely educational activities would

be to take too narrow a view of them. They do not merely improve public taste ; they actually direct consumption into channels which are thought desirable.

We pass next to matters in which State enterprise is still the subject of controversy. Housing has acquired a special prominence at the present time all over Europe. The market for dwelling-houses was utterly disorganized by the War. When prices rose all round, people for a long time did not understand that the cause was the depreciation of the currency. It seemed that, whatever might be the case with commodities, at any rate there was no good reason for raising the price of houses. Pressure was put on Governments to restrict rents by law. The effect of legislation passed with that object was that the cost of house room was less than before relatively to wages and other incomes, which had been raised in nominal amount through depreciation. All the people who could get housing accommodation at all could afford more of it than under pre-War conditions. The existing stock of house room was, therefore, used up by a smaller number of people. So long as a large part of the adult population were away in the army, the shortage was hardly felt. When they returned, a housing crisis immediately supervened.

The policy of rent restriction, even where it did not expressly apply to new houses, reacted disastrously upon new construction. Building speculators felt no confidence that they would be permitted to receive a profit. In the conditions prevailing in 1919 and 1920 a remunerative rent would have had to be much higher in proportion even than the swollen prices of commodities. For while the first cost of a house had risen in at least the same proportion as the general level of prices, the rate of interest had also risen to a very high figure. Rent had to cover this high percentage of the high first cost.[1]

There was no way out but for public authorities to take action themselves. In England the task was devolved on the local authorities, though the financial responsibility was assumed (subject to a very modest local contribution) by the central Government.

This was, as it turned out, a transitory phase. The period of extreme high prices and high interest was short. But even so a return has not been found possible either to unrestricted rents or to unaided private enterprise.

The problem has, however, become one of the supply of

[1] The speculative builder would want 8 per cent. on £1,000, or £80, instead of 5 per cent. on £300, or £15.

labour and materials, but especially of labour. It is an interesting example of the limitations of Socialism. The authority of the State may be powerless to secure the admission of additional numbers into a trade, even when public policy urgently requires the extension of its output, and when there is a serious unemployment crisis in other industries.

Public control of housing offers a wide field for Socialism. The dwelling-houses of a country form a very substantial part of its aggregate capital wealth. In the environment of the inhabitants they are the most important constituent created by human agency. They are important, not only positively, as a means of health and comfort and as a vehicle of applied art, but negatively, in that buildings may mar the countryside.

State housing schemes are intended primarily to bridge the gap between supply and demand with a subsidy. But they could readily be adapted to stimulate quality as well as quantity. Certain minimum requirements in regard to sanitation, space, safety, and other matters are imposed by by-laws. Where public authorities themselves are responsible for building, they can adopt suitable standards not only in these but in other respects. In particular they can follow out a scheme of town-planning, and can employ good architectural designs. Such activities require a high degree of taste and enlightenment in the public authorities concerned. If those qualities are lacking, the result may be worse than with unrestricted private enterprise.

Another industry in regard to which the question of nationalization has come within the sphere of practical politics is that of coal-mining. This has been so in England particularly since the famous Sankey Report of 1919. The case of coal-mining differs from those of education and housing in that nationalization has been proposed primarily for the benefit not of the consumers but of the workmen employed in the industry A claim for increased pay and reduced hours had been met with the objection that the industry could not stand the increased costs, and nationalization was called in aid as a means of more efficient and economical working. which would get over the difficulty

Coal-mining has some of the characteristics of a public utility. The economical working of a coal-field, like the construction of a railway, requires agreements with the owners of the different parcels of land under which it lies. But the case is not quite parallel to that of the railway, for it is to the direct pecuniary interest of every land-owner

to have his minerals worked, and the refusal of one or two recalcitrants, though it may cause inconvenience, would not as a rule actually prevent mines being worked under the neighbouring estates. The dependence of an industrial community on its coal supply may be compared to the dependence of a town on its water supply But here again the parallel is incomplete, for effective competition is impossible in the water supply, whereas it usually exists in the coal supply.

The case put forward for nationalization is that, though competition among coal-mines is practicable and effective, it is wasteful. Workable coal is left untouched near the boundary between two mining properties ; pumping could be carried on more effectively and cheaply if it were possible to treat different mines together. When a mine is worked for profit, the owner is tempted to extract all the coal that can be cheaply worked, and to leave the rest underground, whereas consideration for the future would lead him to bring all workable coal to the surface. Other disadvantages attributed to competitive working of mines might be mentioned.

Whether the case has been made out against competitive working is a technical question which we need not pursue. But *if* it is wasteful, then nationalization should produce a real gain, and with given costs and wage rates, this gain would go to the consumer. But as we saw, the immediate aim of the proposal was not to lower the cost to the consumer, but to make higher wages and shorter hours possible without an increase of price. Trade unionism has some of the characteristics of an industrial monopoly. In industries which produce for a world market, it cannot get this result without an international organization. For coal on the other hand the cost of transport is heavy in proportion to the value of the coal, so that every coal-field has a decisive advantage in the markets close to it. A trade union which includes all the miners in a coal-field is in a position to secure monopoly profits in the form of increased wages. It is as advantageously placed as a trade union which comprises all the workmen engaged on an essential public utility. These monopoly profits can only be secured at the cost of some shrinkage of sales and therefore of employment (probably in the form of the shutting down of the least profitable mines). Nationalization is a device for avoiding these undesirable results by more economical working, if this is secured, or by a sacrifice of profits.

The whole question brings out in an acute form the defects of the labour market, which we discussed in Chapter XXVII

The miners cannot fairly claim a preference over other industrial groups. But how is it possible to decide what the relative levels of wages ought fairly to be in mining and other industries? Who can compare the skill of a miner with that of a watchmaker or of a navvy or of a tram-conductor? And who can assess in terms of remuneration the disadvantages of working underground and under dangerous conditions? Incidentally coal-mining is an industry especially exposed to the effects of the trade cycle. Much of the trouble in the industry in recent years has been due to the severe depression which has existed since 1920.

Perhaps the nationalization of coal-mines would hardly have been proposed on any of the grounds ostensibly adduced for it, unless it had been favoured as an instalment of collectivism. So regarded, it would stand or fall with the complete policy of collectivism, which we have already discussed.

Another measure which is advocated as an instalment of collectivism is the nationalization of banking. But for this likewise arguments can be put forward on its own merits, and it deserves a little examination.

In the first place banking again is a business which has some of the characteristics of a public utility. Sometimes the business in a locality is insufficient to support more than one bank, and the bank established there has a monopoly. When several banks serve the same district, there is duplication and waste of effort.

Payments made between customers of the same bank give less trouble than those between customers of different banks, which involve clearing operations. Every bank has to provide a sufficient margin of cash to cover possible and quite incalculable liabilities at the clearing. Clearing operations include the settling of payments between one place and another, and these can be effected most smoothly and easily when a single bank has branches in both places.

These advantages of concentration, though not negligible, are hardly great enough of themselves either to account for the insistent tendency towards amalgamations and mergers, or to justify nationalization.

A more potent advantage is that arising from the combination of capital. The capital of a bank is required as a guarantee fund against bad debts and other losses. If the bank's obligations are to be used as means of payment, its solvency must be unimpeachable. Losses conform to the law of averages. The larger the business conducted by the bank, the smaller in proportion is the margin required to

provide against losses, or, with a given proportional margin, the better is the security against insolvency. The bigger the bank, the better its credit. Incidentally also there is less opportunity for imprudent speculation and other malpractices in a big and highly organized institution, than in one which can be managed by one or two individuals.

The tendency to concentration of banks can be prevented. Legal enactments may prohibit branch banking, linked directorates, working agreements, and the acquisition of control by one bank in another. This system has its disadvantages, and is not easy in all respects to enforce. Where it is not adopted, amalgamation sets in and breaks down all barriers.

When four-fifths of the banking business of a country is in the hands of half-a-dozen great banks, the competition among them begins to look absurd. In every place where the demand for banking facilities is great enough, branches are set up by several of them side by side, each with a separate building and a separate manager and staff. If there were only one bank in the place instead of several, there could be a single principal branch at the centre with a higher paid and more responsible manager than there could be in any one of a number of competing branches, and there could be sub-branches more conveniently distributed in the locality. The advantages are not unlike those of having a single post office organization.

If concentration is carried to such a pitch that there is only one great bank, nationalization is unavoidable. No community could tolerate a private monopoly of banking. Yet if concentration stops short of that point, it can only be because the banks refrain from doing what it is their interest to do.

Banking has two sides, the clearing of payments, and short-term lending. It is the clearing of payments which has analogies with a public utility like the post office. Short-term lending on the other hand is not a business which specially demands concentration. There is a market in which the banks compete as lenders, and no one of them can afford to offer less favourable terms than the others. But the market works imperfectly, because one of the factors is always the position of the borrower, and that is a matter upon which the lender has to form an opinion according to his personal judgment. The natural tendency of the banker is to refuse to lend except on adequate security and to insist on the security (whether merchandise, marketable investments, or real property) being legally pledged.

This is often inconvenient to the borrower, and if he is a wealthy and powerful trader he will play off one banker against another and will offer his custom to the one which will accommodate him most easily. He can, perhaps, insist on being lent money, when he needs it, on an unsecured overdraft. And besides the security, the rate of interest and the commission charged will vary according to the standing of the borrower.

Since one trader does not know on what terms another does business with his banker, there is room for much inequality of treatment. And those traders whose credit is good enough for them to demand concessions naturally differ widely in the extent to which they take advantage of their position.

Nationalized banking would avoid these inequalities. On the other hand a single publicly managed bank would probably have to impose rigid rules as to security and rates of interest, and there would be a loss of elasticity. The concentration of banking in England into the hands of a small number of very large institutions has already had this effect. A private banker, working on a small scale, could use his own judgment as to the credit of a customer, and was answerable to no one. His business was in fact firmly entrenched in his special knowledge of the character and circumstances of each customer. No rival new-comer would know how much to lend to each and on what terms. A mere manager has to act on instructions from above. Within his instructions he must be allowed to exercise some discretion, in order to outbid the managers of the branches of competing banks, but this discretion is less than that of an irresponsible private banker.

Not only would a manager in a branch of a nationalized bank be bound by instructions, but he would not need to be given discretion to depart from them. No discontented customer would have the alternative of transferring his account elsewhere; none therefore would have the power of obtaining preferential concessions. Bankers who are accustomed to the judicious adaptation of terms to the credit, the power, and the exigence of customers, are apt to regard this as an essential part of banking. But it is the stronger traders who get the concessions, and it is they who could best afford to do without them. It is not at all clear that the establishment of rigid rules would not be a gain. Nationalized banking does not necessarily mean a Government monopoly of short-term lending, and an element of elasticity might be provided by private capitalists who

could make advances either out of their own resources or from sums borrowed on their credit from the State bank.

With nationalized banking the control of credit and, therefore, of currency, could be effected more directly and simply than by a central bank exercising influence over a number of independent banks.

If banking were a purely internal affair for each country, there would be much to be said for nationalization. The real difficulties arise in international dealings. Governments fit ill into credit transactions. Their creditors find them difficult to bind, and have every reason to fear political considerations intervening to complicate what should be a plain business relation between debtor and creditor. Every Government has an unfair advantage in legal proceedings in its own territory. The position of a Government as a creditor is almost equally unsatisfactory; it is amenable to pressure, and any important transaction is liable to slip into the diplomatic sphere as soon as the slightest complication arises. In the routine of deposit banking and the business of lending through bills and advances to traders under the Government's own jurisdiction, the official authority on which a national bank would depend could be kept in the background. As soon as the authority of another Government comes into the question, the difficulties begin.

The nationalization of banking is usually advocated not on the ground of the waste involved in competition, but because the power of the bankers is said to be too great to be entrusted to any private interest. There is a certain confusion of thought as to the scope of banking. The spectacular power of the great financier emanates, not from deposit banking, with its usual accompaniment of short-term lending to traders, but from the big operations of the investment market. The power is that of the issuing houses and the promoting syndicates. To nationalize their business is to nationalize the investment market itself. It would impose on the Government the responsibility of placing the investible funds of the country. Such a proposal could hardly be put forward at all except as a part of a programme of complete collectivism.

We shall refer to one more example of the many plans for nationalization which come up for discussion at the present day, and that is the proposal for the orderly marketing of staple agricultural products, especially foodstuffs, by a public authority. The markets for agricultural products are peculiarly liable to suffer from glut, partly because the supply depends upon crop conditions and cannot be regulated

closely with reference to demand, and partly because the demand is in most cases inelastic. The remedy is to be found in the concentration of marketing in the hands of bodies powerful enough to steady the supply by holding back a portion in stock as soon as a glut threatens. But a marketing agency of that type, unless it is controlled, threatens to exercise the evil power of a monopoly. Hence the proposal for Government participation.[1] Here once more we see State interference proposed because the free market does not work perfectly, as in the case of public utilities. There is a tendency, however, to advocate the proposal not merely on this ground but for the purpose of eliminating profit, and bringing the price to the consumer and the price to the producer nearer together. The elimination of profit is a principle which has no resting place short of pure collectivism.

[1] See "Stabilization," by E. M. H. Lloyd, and "The Agricultural Crisis," by R. R. Enfield.

CHAPTER XXX

TAXATION AND SAVING

TO the Collectivist State taxation is not necessary, for it is merged in profit. Taxes on wages and salaries paid by the State itself or on commodities sold by it, are merely disguise for an extra profit. If, owing to political pressure, improvidence, or any other cause, the profits received by the State are insufficient, the deficiency can hardly be made up by taxation. The taxation of incomes derived from such business as is outside the State's control is likely to be a modest affair.

On the other hand a predominantly individualist State which carries on a limited number of nationalized services must still rely on taxation. Some nationalized services, such as railways and post offices, may be expected to yield revenue, and presumably nationalized mines or banks would be of this class. But those services, like education, which the State supplies expressly because the unassisted demand from the consumer is deficient in comparison with the standard regarded as desirable, involve a net outlay which may be very heavy.

The equalitarianism which seeks in collectivism a plan for reducing or even eradicating inequalities of income, finds a palliation for those inequalities in graduated taxation. According to the doctrine of marginal utility a certain amount of graduation is required even to secure the ideal of proportionality of sacrifice. For the rich man must pay not merely a greater sum, but a greater *proportion* of his income than the poor, if he is to give up an equal proportion of the total utility he enjoys.[1]

To redress the inequalities at all, a steeply graduated

[1] The part of his income that the taxpayer gives up is that of which the "utility" is least. If one with an income of 100 has to pay 10, and one with an income of 200 has to pay 20, the utility of the 10 that the latter pays in respect of his first 100 is less than that of the 10 that the former pays in respect of his only 100.

scale is needed. The question of graduated taxation has acquired a new importance owing to the enormous tax burdens left behind by the War. The socialistic demand for graduation has been reinforced by the perplexities of finance ministers at a loss to find any plan for raising the revenue required. The field of indirect taxes is limited A heavy tax on a commodity diminishes consumption Numerous but moderate excise taxes are vexatious, and costly to collect. Customs duties without corresponding excise duties are protective in effect, and if high are likely to produce comparatively little revenue. Recourse to heavy direct taxes becomes unavoidable.

Graduation can only be effectively applied to a tax assessed on the resources of individuals, whether capital or income.[1] A tax on capital may take the form of a duty payable on the transmission of wealth by death to a new owner, or of a more general tax (recurrent or non-recurrent) on wealth held. Taxation of incomes overlaps taxation of capital, because the holder of capital which yields income pays both. Income taxes are sometimes framed to differentiate between different sources of income, those derived from capital paying higher rates than those derived from personal exertions.

When taxation becomes very heavy, and direct taxes are raised to high levels, the question of the limit to which they can go without causing serious injury to the interests of the community becomes an urgent one. A country with a debt so big that it is in any case overtaxed must weigh against every project of new social expenditure the evils of adding to an already excessive burden. To make the comparison, it is necessary to form a clear idea of what those evils are

The most obvious evil is an actual breakdown of the taxing machinery itself. People who are called upon to pay oppressive direct taxes will try to escape the burden either by devices within the law or by illegal evasion. Familiar examples are the gifts by a father of a part of his fortune to his children during his lifetime to escape death duties, and the concealment of money invested in foreign securities from the income tax authorities. Carefully framed tax laws, combined with an experienced and efficient tax administration can reduce evasion, legal and illegal, within tolerably narrow limits, unless the taxpayers to be dealt

[1] Not, e.g., to taxes on particular kinds of capital or income, such as land or houses or shares in companies, nor to taxes on transactions, such as stamp duties on the drawing of bills and cheques, or on capital issues or dealings in investment securities.

with are systematically dishonest.[1] The question we really have to consider is what is the harm resulting from excessive direct taxation when it *is* successfully enforced.

The fundamental principle of individualism is to rely on money as the motive of economic action. If part of the money which the market yields is intercepted by the State, the motive of action is weakened. But it does not necessarily follow, even if the fraction intercepted is substantial, that the motive will become inadequate. The general presumption remains that everyone will aim at securing the maximum pecuniary gain for himself, and this guiding principle will lead him to do exactly the same things, whether he keeps the whole gain for himself, or the State takes a part. This general presumption approximates closely to the truth in most cases, but there are certain circumstances in which it might fail, where for example, the action to be remunerated is particularly distasteful, because it involves an exceptionally great effort or a serious risk of loss. It may only seem worth while to face such drawbacks for the sake of a considerable gain, and, if the prospect of gain is substantially diminished through the liability to taxation, the drawbacks may prevail, and the action not be undertaken.

Undeniably that is possible. But it would be a mistake to suppose that such a play of motives is so prevalent as to be one of the serious results of over-taxation. In the first place gain is for most people only a part of the motive of effort. Every one needs an occupation, whether he is dependent upon it for his living or not, and the amount of time and effort he gives to his occupation (in so far as that is a matter within his own control) is determined primarily by what he regards as a suitable ordering of his life. A change in the amount of remuneration need not necessarily involve any change in the distribution of his life between work and leisure. If it does, it is quite as likely that the man whose gains are encroached on by taxation will work more to make up for it, as that he will work less for want of incentive.

The effect upon the taking of risks is not quite the same as upon the making of effort. Where gains are taxed, and losses cannot be set against them, the scales are loaded against risky enterprises. Where a business consists of a large number of separate transactions each involving a risk

[1] In the case of a properly planned income tax law, evasion on a considerable scale probably means the laborious preparation of complicated false statements, which have to be made internally self-consistent, and to be defended at need in cross-examination. Evasion of death duties by gifts *inter vivos*, even if it involves a breach of the law, is likely to put a less formidable strain on the consciences of those who benefit by it.

of loss, the income from it will naturally be calculated by deducting current losses from gains. The difficulty arises when the whole capital embarked in an enterprise is liable to be lost or gravely impaired. The capitalist will not risk such a loss unless he expects an exceptional profit in case of success. If he is subject to a uniform income tax without graduation, so that he pays the same proportion of a large income as of a small, his calculations will not be interfered with. For what he will lose if his capital is destroyed is the prospect of the income that he could get from it if he chose a straightforward investment free from risk. This income is itself diminished by taxation, and the compensation for risk will be diminished in the same proportion. He has £20,000 to invest, and could get a safe £1,000 a year for it. He is prepared to take a risk of loss if he can expect, in case of success, an income of £1,500 a year. The extra £500 a year is compensation for the risk of losing the whole capital and getting nothing instead of the safe £1,000.

If a uniform income tax of 20 per cent. is imposed, what he loses is not £1,000 a year, but only £800, and the compensation, reduced from £500 to £400, is still adequate.

But if the tax is graduated, and amounts, e.g., to 10 per cent. on the first £1,000, and 20 per cent. on the next £500, his loss in case of failure is £900 a year, whereas his extra profit in case of success is only £400, and is no longer in the same proportion.

Considering the dead weight of inertia that in any case tells against innovations, any serious discouragement of new ventures is undoubtedly an evil. But in practice close calculations either of risks or of prospects of exceptional profit are so impossible that it is doubtful whether the discouragement is anything worth considering. Disproportionate importance has been attached by economists to the discouragement of enterprise in this way, owing to their tendency to regard profit as to a great extent compensation for risk.

This is an error arising from the fallacious analysis of profit into interest, compensation for risk, and earnings of management. It is too palpably evident that only a very moderate part of the profits of a big business can be set down as "earnings of management," especially when it is equipped with an ample staff of directors, managers and experts with high salaries and the excess remaining to be attributed to compensation for risk, when interest at market rates on the capital outlay has been allowed for, becomes very large.

But this excess is in reality for the most part pure profit.

Profit is the privilege of those who possess trading goodwill. It is out of profit that fortunes are made. One who cares for money-making, and sees profit within his reach, will not be easily deterred from using his opportunities. He will not incur on any terms a serious risk of losing his capital; a small fraction of the profit is in most cases an adequate premium upon such risk as he does take.

In most cases the kind of loss he really fears is loss of *goodwill*. This is quite a different thing from a real loss of capital, though a trader will sacrifice his capital in efforts to save his goodwill. So far as goodwill is concerned, one trader's loss is his rival's gain.

A real loss of capital occurs when the demand which an enterprise was started to meet does not materialize. It is especially in experimental investments of capital that the risk of loss calls for compensation in the form of exceptional profit. The extent of the risk is a matter of judgment, and the man who undertakes it does so because *he* believes the risk to be small. If he did not, he would be a mere gambler —and a very suitable subject for high taxation!

It is in relation to savings that the really serious harm of excessive direct taxation arises. Its detrimental effects upon saving are often attributed to the reduction in the yield of investments. This explanation is built upon the theory that the motive for saving is the prospect of receiving interest. The smaller the interest, it is said, the weaker the motive for saving. We have seen in Chapter XIX that this theory is quite untenable. The presumption may even be said to be the other way. In so far as people save to provide for the future, the lower the rate of interest the more they may be expected to save.

The real fault of excessive direct taxation is that it draws away a part of the resources *available* for saving. It is not the taxation of interest or of capital that discourages saving, but the taxation of profits.

It is the normal career of a trader to accumulate profits during his active years, and then to retire and live on the interest of his accumulations. If he is very successful, far the greater part of his profits will be accumulated. Suppose that he has to pay a very heavy income tax. It may be that only a very small part of the tax can be met by economies in his style of living. A man who possesses £50,000 of capital and is earning £20,000 a year in profits, may spend perhaps £3,000 and save the balance. If he has to pay £7,000 in taxes, he may decide to spend only £2,000, but even so his savings are reduced from £17,000 to £11,000.

When the State makes encroachments of this magnitude upon profits, it is assuming some of the responsibilities of the collectivist State. It is taking into its own control a part of the funds available for capital extensions, and unless the State itself applies the money for capital purposes the growth of capital will be retarded.

Where there is a big national debt, the money can be made available for capital purposes by being applied to a sinking fund. But if it is so applied, or if it is used for capital enterprises undertaken by the State itself, the money is diverted from other objects of expenditure for which *ex hypothesi* revenue is needed.

If these objects of expenditure include a large amount of debt interest, to that extent money will be raised from one set of rich people to be paid away to another. But people do not necessarily save merely because they are rich. The typical rentier, living on the interest of his capital, has very little motive to save ; at any rate he will save far less than the trader who is receiving fluctuating profits which will only last as long as he continues in business.

Thus the real injury to a country from an excessive national debt is the transfer of a great part of the national income to a class of people who have no motive to save because their income is too perfectly secured. And here is to be seen the real defence for the plan for a capital levy, which has been so much discussed in this country and elsewhere since the War. If a great part of the burden of taxation can be shifted from income to capital, profits will be released for their natural function of accumulation. Against the capital levy it is argued that a partial confiscation of wealth would diminish the motive for saving. What is proposed is a drastic tax on capital once and for all, to be applied in reduction of debt. But there is no certainty that, once successfully tried, the levy may not be repeated to clear away new accumulations of debt due to lavish remissions of indirect taxation and lavish social expenditure. Successive levies, it is said, might in the end amount to a practical confiscation of fortunes till all motive for saving would be taken away.

These fears are largely due to the fact that the proposal for a capital levy has been adopted by Socialists, some of whom regard it as a step towards collectivism. If the proposal were put forward as a definitely Conservative measure and taken on its merits, it would be regarded as a transfer of burdens from *future* savings to *existing* savings. Future savings would be doubly relieved, for the profits out of which

they are to come and the interest on the accumulations when realized would alike be less burdened by income tax.

Most of the objections to a capital levy are directed against the raising of a very large sum at once. For example it would be difficult (though not, I think, impossible) to carry it through without a serious disturbance of credit. When the taxpayer's liability is very heavy, there is likely to be extensive evasion.[1] And when the taxpayer has to part with a substantial portion of his capital, his future taxable capacity is reduced. Sir Josiah Stamp calculates that if a heavily graduated capital levy were applied to the United Kingdom, calculated to yield £3,000,000,000, and to save about £140,000,000 of debt interest, there would be a consequent decline in the yield of income tax, super tax and death duties exceeding £90,000,000 a year.

But if the main purpose is to transfer the burden of debt redemption from income, and especially from profits, to capital, this can be done by a moderate *annual* tax on capital. A mere transfer of the tax burden from earned income to "investment income" would not quite do what is wanted, because investment income often includes an element of profit. Even the market values of shares would not give the required taxable basis, because such values usually include a certain amount of capitalized profit or goodwill. For a genuine tax on capital, a special valuation of physical assets is needed.

A tax moderate enough to be paid out of income would only make very slow progress in redeeming such a debt as at present exists in England, France or Italy. As soon as it is made so heavy that it must, in most cases, encroach upon capital, it acquires some of the characteristics of a levy, and the question is anxiously asked, whether the tax will cease when the debt has been redeemed. A heavy annual tax, however, of this kind, imposed for a term of years, escapes some of the objections to a capital levy.

As the liability is not concentrated in a single year, there is not the dangerous inducement to achieve evasion once and for all. Again even if the taxpayer finds himself compelled to encroach on his capital, he at any rate has some opportunity to meet a large part of the burden out of income. The impairment of the working capital of traders is avoided or at any rate reduced to small proportions.

In so far as the tax is met out of income, the advantages

[1] A man with a big fortune, sav £1,000,000 yielding an income of £50,000, would g to much greater lengths to escape liability for a single payment of £300,000 than to escape an annual liability of £20,000.

of a sinking fund are secured, in that the funds available in the investment market are increased, and the rate of interest is lowered. These advantages are at the maximum when the revenue is raised from taxpayers, like those of the rentier class, who have little or no motive to save out of income for their own purposes.

If the tax is for a limited period only, the inducement to save is preserved for those who look forward to relief from burdens on the income from their accumulations after the end of the period. That depends on the possibility of establishing confidence that the tax would not be prolonged or repeated.

The problem of a capital levy arises out of the existence of excessive national debts. An excessive debt overstrains the tax machine, leaves insufficient revenues for Government expenditure on social reform or on anything else, and by burdening profits curtails the supply of savings. But even in a country with no exceptional debt burden the conflict between expenditure on social reform on the one side and the exigencies of saving on the other may arise. The policy of diminishing inequalities by raising money from the rich and spending it for the benefit of the poor involves the graduated taxation of big incomes. Such taxation, so far as it goes, will encroach on accumulation. In fact as soon as the State begins to divert a substantial part of profits to its own purposes, it is faced with the same sort of problems as the collectivist State, which monopolizes all profits. Either the State must itself make up the deficiency of savings and become an investor, or it must so frame its system of taxation as not to fall too heavily on profits ; for example it might to some extent substitute permanent taxes on capital for income taxes.

Professor Bowley, in the course of a very informing investigation in his *Division of the Product of Industry*, calculates that in the United Kingdom in 1911, if the excess of all incomes over £160 a year, excluding those derived from abroad could have been made available for a division among the population, the sum to be divided would have been £550 millions, out of which £300 to £350 millions, would have to be deducted for Government expenditure and for maintaining the supply of savings. Professor Bowley's hypothesis is, of course, a highly abstract one. He has deliberately left on one side all questions as to the methods by which the division might be carried out and as to the possible loss of income in the process.

The result, taken as a purely statistical one, is of consider-

able interest. It refers solely to income derived from home sources,[1] and the income derived from abroad and excluded is estimated at £194 millions. Even so the large proportion of the incomes of the well-to-do applied to taxation and to saving is sufficiently striking.

Professor Bowley's calculations throw some light upon the magnitude of profits. He uses Sir J. Stamp's estimate, that in 1907 out of a net output of £592 millions from manufactures and mining, £188 millions went in profits, interest and rent. From this sum he deducts £7,000,000 for mining royalties and £48,000,000 for interest on £1,200 millions of capital, leaving £133 millions of profits. His calculations for 1911 are not quite comparable with this, because he includes in the total for industry and mining certain non-profit-earning undertakings, which were excluded by Sir J. Stamp. But out of the £238 millions which he gives for profits, interest, etc., in that year, perhaps profits may be put at something over £140 millions.

For Agriculture net output is put at £176 millions, and wages and salaries at £64 millions, leaving £112 millions for rent interest and profit. Annual value of land for income tax purposes was £52 millions (a part of which would be economic rent properly so called, and a part interest on capital sunk in the land). Of the balance of £60 millions a part, which is difficult to estimate, must be assigned to interest on the farmers' capital.

In the case of railways it is impossible to say what part of the £47 millions yielded to the shareholders and debenture holders must be regarded as interest and rent. The element of profit is hidden away in their history, and now-a-days takes the form of dividends on watered capital. In view of the capital expenditure gradually incurred out of income, it may well be that this watered capital has almost disappeared and been replaced by real capital.

There remains to be estimated the amount of profit on wholesale and retail commerce. Professor Bowley includes in a single total of £195 millions the profits, interest and rent of commerce with those of transport (other than railways), catering, and some other activities. He allows a very considerable proportion of this sum, £74 millions, for incomes below the income tax limit of £160, these being chiefly small shopkeepers and dealers. That leaves £121 millions for incomes above that limit.

Professor Bowley does not attempt to estimate the amount of interest on capital included in these figures. The pro-

[1] Including however the profits of shipping and foreign trade.

portion should be substantially less than in production, and particularly small in the case of wholesale commerce. Without attempting a precise estimate, we may conclude that profits from home business amounted to something of the order of magnitude of £300 millions, of which fully three-quarters would be in incomes above £160.

To this must be added so much of profit as is included in the income of £194 millions from abroad. Of that sum £36 millions represented interest on Government securities, and in the remainder of £158 millions interest on capital would certainly represent a high proportion. But even so profits (especially mercantile and financial profits) must have amounted to a large figure—some scores of millions perhaps in all.[1]

If we consider how slight are the motives for saving in the case of the possessors of substantial incomes from real capital, and how slight is the capacity for saving from small incomes, we realize how large a proportion of the big incomes derived from profits must be devoted to saving. It may be mentioned that the total savings of the United Kingdom in 1907 were estimated at from £325 to £350 millions (inclusive of accumulations of durable but non-income-yielding goods like furniture, clothes, utensils, ornaments, etc.) Life insurance accounted for net savings (after deduction of expenses) of some £40 millions, and that was probably the greater part of the savings out of salaries and wages. The savings out of profits, interest, and rent must have been something comparable to £250 millions, and the share of profits in this total would be very great.

If the total of pure profits (including those derived from abroad) amounted to £350 millions, almost certainly more than half that sum must have been applied to saving. For the relatively large incomes derived from profit the proportion must have been far above half. The effect of a very heavy income tax on saving becomes obvious.

But how much saving *ought* there to be? The question is a fundamental one, and yet how difficult to answer! The actual rate of accumulation under the conditions we know is the result of chance. Saving is a by-product of large but

[1] It appears to me that estimates of invisible exports have usually allowed much too little for profits, and particularly for mercantile profits. All profitable dealings by merchants of a country in imports before they are valued on arrival, or in exports after they are valued on departure, or in goods in foreign countries which never cross the frontier at all, yield invisible exports. The income derived from abroad by great commercial countries like England and Germany has probably been seriously underestimated in this respect.

precarious incomes. It arises partly because the recipient of a precarious income is forbidden by prudence to spend it all, partly because the recipient of a large income does not care to spend it all. The amount of incomes from which this valuable by-product is derived has no relation to the capital needs of the community.

The general attitude towards saving is that it ought to be encouraged and stimulated in every possible way. One underlying reason of this enthusiasm for saving is the recognition, not usually avowed, that most of the objects of expenditure are pure waste. What is sacrificed for the sake of saving is therefore in reality of little account. The danger that people will sacrifice not merely superfluities, but objects of expenditure which are really desirable, is regarded as negligible. Indeed there is often quite as much danger that desirable things or even necessaries will be sacrificed for the sake not of saving but of superfluities.

Saving in itself is a gain from all points of view. To the mercantilist it is the embodiment of economic strength. But it also promotes welfare. An increase in capital means either more production or the same production with less effort. It has in fact the characteristics which we have discovered in False Ends. That does not imply that its desirability is fallacious. Nevertheless it is incumbent upon us to look beyond the mere fact of saving, and to see whether the purposes to which the accumulation is to be applied are themselves desirable.

When the question at issue is the encroachment of taxation upon savings, we have to weigh the advantages of accumulation against the benefits to be secured from the taxation. These benefits are partly the direct effects of spending the money (on social reforms for example) and partly the tendency towards equalization of incomes It is where the money is spent on social reform that the case is strongest, for then the equalizing tendency exists, while the additional resources of the poorer classes are determined by the social policy of the State instead of by the unaided wisdom of the individual. Even so, however, the argument for accumulation is a powerful one. Accumulation increases the taxable resources of the State. By waiting the community may get in the next generation all the benefits of social reform and accumulation into the bargain. Social reforms of a kind which materially increase the productive efficiency of the people, may have as favourable an effect as accumulation itself in increasing future taxable capacity. Expenditure on education and health, and on services, such as housing, which

react favourably upon physical and mental development, may be justified on this ground. But the difficult decisions are called for when the social reforms proposed are clearly desirable in themselves, but are not such as to promote productivity.

Space would not allow us to pursue this difficult and important question here. But it may be pointed out that the collectivist system has the advantage of making accumulation a function under the direct control of the State, instead of leaving it to the fortuitous working of individual motives. The conflict between accumulation and the immediate welfare of the people is more direct, but it is not complicated either by the vagaries of the taxpayer or by the possibility that the increased productivity will be applied to conventional superfluities.

CHAPTER XXXI

CONCLUSION

If in conclusion we are to survey the ground we have covered, our first task should be to determine what is the proper scope of our subject That is a question which we have left on one side since the opening chapter.

In Chapter XVI we found reason to reject the classical economists' definition of their subject matter as Wealth But what are we to put in its place ? We have defined the economic problem as that of utilizing the capacity of mankind for joint action. But this definition by itself seems to be too wide. Joint action is to be found in war, in sport, in politics, in religion and in many other activities which, even if they have an economic side, are not themselves part of political economy. What we seek is a principle to delimit the part of such matters which belongs to the economic problem from the part which does not.

We have described our problem as that of so playing on human motives as to secure joint action for the desired ends. It does not comprise the entire sphere of human co-operation. We may distinguish between the *economic* problem of how to secure joint action, and the *technical* problems of how to employ the joint action, once it has been secured, on the prescribed task In seeking solutions of the economic problem we cannot disregard the technical problems, because the manner in which the former is solved may react in many ways on the latter. Any solution of the economic problem must be tested by its consequences, including its effects upon technical methods. Nevertheless the technical problems and their solutions are themselves outside the sphere of economics.

If one of the ends to be attained is the supply of boots we may compare the efficacy of slave labour, of a traditional caste system, of individualist markets and of a collectivist State in securing the necessary co-operation. These are

different ways of ensuring that tasks shall be allotted and that everyone concerned will perform his allotted task.

To compare them, it is essential to consider how far in each case the requisite material equipment and human skill and industry and organizing authority will be secured. We must know enough of the technical problems of boot-making to judge of this, but the technical problems themselves are a separate study The economist does not have to learn how to make boots.

The same distinction arises everywhere. In railway construction, when we discuss whether the State or profit-seeking capitalists shall promote the enterprise, which shall manage it after it is completed, how the route shall be determined, what shall be the source of the discipline exercised over the staff, on what principle charges shall be settled, these questions lie in the realm of economics. So likewise do questions of the effects of railways upon the distribution of population, upon the growth of interposts, upon the development of natural resources, or upon economic rent. On the other hand, the engineering problems of railway construction and the problems of traffic management are technical.

In the case of an army, strategy, tactics and army administration are technical matters. But the problem of how to apply a community's resources, human and material, to the raising, equipment, movement and maintenance of an army is economic. The technical side is not wholly irrelevant to economics, because the manner in which human nature is directed to the creation of an army cannot be dissociated from the uses to which the army is to be put. In deciding how far the people who have to co-operate in the task are to be moved by compulsion, by payment or by a voluntary sense of obligation, the chief consideration must be by which method the best army will be formed. The *best* army is that which best meets the needs of war, and some knowledge of the art of war is requisite for an adequate consideration of the economics of an army.

The economist needs some knowledge of technicalities, such as those of boot making, of railway construction and management and of the art of war, just as he needs some knowledge of arithmetic, but these technicalities, like arithmetic, are not part of his subject.

Political science, it may be noted, is to be excluded from economics as a technical study. Given that there is to be a sovereign state, political science shows how it is to be constituted.

The common characteristic of technical problems is that they arise when some limited or *intermediate* end is given. When a man has made up his mind that he will make boots, the manner of making them becomes a technical problem. But then, it may be asked, why cannot wealth itself be regarded as an intermediate end? Economics could then be treated simply as a technical study, divested of all complications outside its limited end. Such a study might exist, and would include a great part of the economic field. But economists are in any case not content with any such limitation. They feel bound to defend the pursuit of wealth (or rather of utility or satisfaction) as conducive to welfare.

Moreover, wealth is not an intermediate end of the same type as boots, warfare, or railway transport. Those are ends which people actually pursue. The production of wealth *as such* is not. Men do indeed seek to *acquire* wealth But as soon as they look beyond money they aim not at wealth in general but at particular products. Products are intermediate ends, and money is an intermediate end. Wealth is an abstraction. Money-making may be treated as a technical study, but that is not economics.

The production of wealth is undoubtedly often pursued as an intermediate end by statesmen and others, who seek to promote it by means of legislative and administrative measures But in so doing they are acting on the theories of economists; they are looking beyond their intermediate end to some ulterior end, such as welfare or national power. Economics cannot be reduced to a technical study of the pursuit of wealth or utility, unless wealth or utility can be shown to be the means to such an ulterior end. When we found that utility was an abstraction with no definite relation to welfare, we were bound to abandon it as an intermediate end. Our treatment of the economic problem became not technical but philosophical.

It is the characteristic of philosophy to admit no limitations on its subject matter. In one aspect it aims at discovering the ultimate nature of things. That is a pursuit which leads to regions indefinitely remote from human life On the other hand philosophy criticizes human conduct, and here it equally divests itself of all limitations; it insists that *everything* shall be taken into consideration. But here it is really assuming an essentially practical point of view. For whereas abstract theorizing isolates some aspect of its object, and its conclusion applies only to the part so isolated and never to any actual concrete thing, practical judgment

always has to deal with actual conditions as a whole, and cannot afford to disregard anything relevant.

In economics the conflict between theory and practice is familiar to everyone. Theory is all right in itself, but, when we come to apply it, we are confronted with a medley of disturbing factors which defy calculation. There is no royal road to the reconciliation of theory and practice, but in one respect philosophy can help. For the conflict often arises in reality from a difference as regards ends. Philosophy insists on including the criticism of ends in the province of economics.

Accordingly our discussion of the economic problem has been very largely concerned with ends. We have endeavoured to show how far current controversies are ultimately concerned with ends as well as with methods. It may be added that it is by differences in regard to ends that most of the heat in controversy is generated.

The concept of wealth covers a wide variety of ends, everything, in fact, that is valued in the market, whatever may be the ground on which it is sought by the purchaser. Its standing as an intermediate end depends upon the value of the ulterior ends for which it may be sought, and cannot be assessed without a criticism of these ulterior ends such as we have endeavoured to undertake.

But that was not our sole ground for discarding the concept of wealth as the subject matter of economics. We found that it is of *insufficient generality*, in that it is derivative from the use of markets. What is not marketable is not wealth, and what *is* marketable is measured by different standards in different markets.

It is the ideal of philosophy always to aim at attaining the highest practicable degree of generality in its concepts. We are conforming to that ideal in adopting a definition of the economic problem, which suits all forms of human society, whether they employ markets much or little or not at all.

Exchange presupposes rights of property in the things exchanged. In a slave-owning society there are rights of property in the slaves, while the slaves have either no power at all or a very limited power of holding property. Under such conditions the meaning of wealth is quite different from that which is appropriate to a free society. Especially is this so where the system of serfdom prevails, as in Russia up to the time of Alexander II. A lord or squire would possess so many souls, attached to the land, and they would supply him with every variety of service. Not only would they

cultivate the land and look after the livestock and perform domestic services, but they would make his clothes and boots, construct and repair buildings, furniture, utensils, vehicles. The estate would form a self-contained community in which the division of labour would be enforced by the authority of the lord in accordance with law and custom.

We have not taken advantage of the generality of our conception of the economic problem to discuss the economics of slave-owning, of feudalism, or of other past social conditions. That ought not to be attempted without extensive and profound historical knowledge. But the need for generality is palpable enough in relation to the controversies of the present time.

The War suddenly showed up all our economic standards from a new angle. In the belligerent countries people became aware of the paramount claims of the State. They were called upon to give up former pursuits in favour of a single transcendent purpose. The economic problem presented itself in an unequivocal form; human nature had to be worked upon and induced to do what the State required it to do. Every combination of payment, persuasion and pressure was resorted to, not only to make people serve in the forces and work at the manufacture of munitions, but to regulate every part of their lives. Controls and rationing were gradually extended in all directions. Markets ceased to function. Prices lost their ordinary significance. Demand usually meant either the demand of the State, or a consumers' demand limited by rationing. Cost meant a total of wages and prices determined by authority and cut off from any semblance of free competition. Wealth no longer had any useful meaning.

The accepted categories of economics may likewise be found wanting in a communist society, in which a great part of the economic benefits take the form of gratuitous services in which there can be no market. Marketable products for example, may form so small a part of the average man's consumption that his money income is very small. The gratuitous products could be reckoned as wealth on a hypothetical valuation corresponding to cost of production, but the cost of production itself is based on the money remuneration of those who produce.

If we proceed now to sum up the results which emerge from our treatment of the economic problem, perhaps the first thing which ought to be noted is the outstanding importance of *profit*. Profit is an incident inseparable from a system

based on markets In an individualist society it is prominent in at least three distinct ways: (1) as the motive for the undertaking of business by those with whom the initiative lies, (2) as the principal source of accumulation, and (3) as the principal cause of the inequality of incomes. Profit is the foundation both of plutocracy and of mercantilism.

Collectivism is above all an assault on profit. If it exalts the power of the State, that is not because the collectivists have any special admiration or love for the State, but because, if the incentive of profit is removed, some other motive power must be found, and none presents itself except the authority of the State. Socialists of all schools hope that the disestablishment of profit will of itself originate changes in human nature, which will bring new motives to bear. Mr. Tawney looks forward to an extension through all occupations of the honourable zeal which we count on finding in the professions. This is itself a separate solution of the economic problem, a solution based like that of primitive society, upon a sense of obligation in the individual, but differing from the primitive solution in that the sense of obligation would be *rational*. It would take the form of a desire to render a service to society; it would not be bound up with a caste-imposed obligation to render a service of a narrowly traditional kind, but would be free to adapt itself to the changing needs of society.

A professional spirit, however, provides only means, not ends. It is in fact *technical*. Its existence would not relieve the collectivist State from the responsibility of deciding what services shall be rendered to it and for what purposes.

Such is the preoccupation of mankind with money and with wealth, that the deficiencies of wealth from the standpoint of ethical value are given little prominence in controversy. Those deficiencies, so far as they are recognized, are often attributed, not to the shortcomings of human nature as interpreted through demand in the market, but to the inequality of incomes.

The inequality of incomes aggravates unwise spending. But inequality is not the whole cause, nor would equalization be anything but a very incomplete remedy. It would perhaps go a long way to remedy the waste incurred in the elaboration of defensive products. If there were no big incomes, no one could afford to spend excessive sums on the prevention of trifling discomforts. But the choice of creative products might actually be made more futile rather than less.

To favour wise spending on creative products, three things are needed: imagination on the part of a few,

appreciation on the part of the many, and technical skill on the part of those who embody the ideas of the few in products for the delectation of the many. Of these three probably the second is that in which improvement is most to be sought. Imagination is an untameable quality, and the best that policy can do is to see that it is neither starved nor obstructed. As to technical skill experience shows that it is usually forthcoming when really demanded.

Appreciation on the other hand requires to be cultivated. In the most attractive forms of Socialism, such as that to which William Morris looked forward, one of the principal aims is to beautify products. Morris believed that if only the natural propensities of mankind could be freed from the tyranny of commercialism and industrialism, an aptitude for the beautiful would make itself felt, both in craftsmanship and in appreciation, both in production and in consumption. Perhaps he was an optimist ; at any rate he was an enthusiast.

Many people would be inclined to think that Morris exaggerated the value of the beautiful. But it is *within the range of creative products* that beauty ranks as so high a good. That does not mean that it outweighs either on the one side those defensive products which are essential to reasonable physical well-being, or on the other those human experiences which are not "products" at all.

The provision of subsistence and the necessaries of life for the entire population ranks, or ought to rank, as the first charge upon economic activity. Those needs once adequately provided for, the field remaining for economic achievement is really comparatively modest. If all the futilities of conventional and undiscriminating expenditure be swept aside, the beautification of material objects forms a arge part of what survives. Alongside it stand those wider applications of art in literature, entertainment, humour, and other forms, to which we referred in Chapter XVII, as well as intellectual products, and the education which fits people to enjoy them.

These activities or products are only a part of human welfare, a part divided off almost accidentally from the whole owing to the exigencies of the division of labour. In order that a man specially fitted for some artistic or intellectual vocation may give his whole time to it, provision must somehow be made by his fellows for his material needs. In society organized as it is that means that he must be *paid* for his work. If the work is marketable, or if he is paid for it, that constitutes it a "product," and his accomplishment becomes economic.

All such economic work has to submit to the taste of the market, that is to say the taste of people in general, "weighted" in proportion to the money they have to spend. Here is the point at which culture can be made effective The taste of the market can be improved.

That should be one of the paramount aims of education. Unfortunately there is no short cut to it, or at any rate none so short as William Morris supposed. A Socialist State may subsidize art and thought, but it cannot be expected to rise above the prevailing standards. Its decisions are in the hands of individuals. They will, no doubt, be selected individuals, but the ground of their selection will probably be that they represent the prevailing standards more perfectly than their neighbours. The faults of official taste are well enough known, and need not be dwelt on.

Creative products demand creative faculties in the producer Mr. Bertrand Russell in the concluding chapter of his *Principles of Social Reconstruction* draws a contrast between the creative and possessive impulses in human nature, the one kind directed to creating what would not otherwise exist and the other towards acquiring or retaining what exists already. "The best life," he says, "is that in which creative impulses play the largest part, and possessive impulses the smallest."

I do not wish to play upon the word "creative," which I have applied in a special sense to products. What Mr. Russell calls the creative impulses may often find an outlet in the creation of what I have classed as defensive products, still more in the creation of things which are not "products" at all. But among products the greatest field for the creative impulses is certainly to be found in the creative products.

Where the creative impulse is at work, the pecuniary incentive is not needed. Remuneration is not required as a motive power, but only as a condition of economic freedom, whether it be derived from the open market, from a patron, from an endowment or from a public authority. But those who control the remuneration control the creative impulse; they decide who shall have the requisite economic freedom and on what conditions, and who shall not. It is in them that appreciation and discrimination are called for.

The problem of wise spending has little place in current economic controversy. It is overshadowed by the great questions of the distribution of wealth, and the promotion of national power.

Where collectivism is not within the range of practical

politics, the controversies as to the distribution of wealth are concentrated upon two subjects, wages and taxation.

With wages we dealt in Chapter XXVII. The conclusion to which our discussion in that chapter points is nothing less than this, that the labour market has broken down. A market ought to secure a balance between supply and demand. In the labour market the response of both supply and demand to price is too slow and too indirect to give the requisite guidance. There is a price, that which we have called the economic rate of wages, at which there would be a balance. But the market has no consistent tendency to gravitate towards that price, and no one knows how to ascertain what it is. It is not to the interest of labour *as a whole* to force wages up above the economic rate. On the other hand the labour *in one industry* may force up wages and yet escape the penalties; it will gain at the expense of labour in other industries. The problem is one of determining the relative rates of remuneration appropriate to different occupations, as well as a standard for labour as a whole. The free working of the market does not afford a solution, nor does the balance of power among trade unions and employers' associations. Incessant friction and ill will are the natural results of the want of any guiding principle. No decision, whether reached by negotiation or by arbitration, possesses any moral force, for no one can ever give any good reason why the decision should not have been other than it was.

If the disturbing influence of the trade cycle were eliminated, and money values became approximately stable, it is possible that the data would become available for a decision which could be accepted as at any rate an approximation to the true economic rate. If the workmen were satisfied that it was the outcome of a genuine effort to ascertain the highest rate that industry could afford to pay without incurring the penalties of shrinking output and growing unemployment, few would be willing to face the miseries of a strike on the chance of getting more. The moral authority of such a decision depends not only on the good faith of the calculation, but also on the fullness of the data. The facts can only be obtained from the employers, and any hope there may be of escaping from wage disputes in this way depends upon their frank co-operation. The system of determining wages by results adopted in the British coal industry after the dispute of 1921 is an interesting precedent. It should be observed, however, firstly, that the prerequisite condition of the elimination of the trade cycle

has not been satisfied, and that the system has up to now only been in operation under conditions of depression; secondly, that the actual wage settlement is a mere rule of thumb, with no real claim to be regarded as an approximation to the economic rate; and, thirdly, that an industry cannot be treated in isolation.

An industry which is in a position to limit recruitment can force up wages. On the other hand an industry which has expanded beyond the demand for its products, and is unwilling to face the abandonment of part of its capital and the transference of part of its personnel into other occupations, cannot escape on those terms from a depression of its wage rates below the prevalent level. Implicit therefore in a settlement of wages is a determination of the proper position of every industry. A comparison between industries involves a comparison of grades of labour. If the labour market functioned perfectly, labour would be automatically graded by the balance between the relative attractiveness of remuneration and the relative difficulty of attaining the requisite qualifications. With an imperfect market the skill and other attributes of each occupation must be assessed in a judicial spirit, so that every industry may be made to pay a fair price for the grades it needs.

A settlement of wages on these lines approaches to the regimentation characteristic of collectivism. The authority which effects the settlement may be one evolved from the organizations of masters and men, or it may be an agreed arbitrator, or it may be a public authority created by the State. Though its attitude ought to be judicial, it would decide such vital issues of economic policy that it could not be altogether separated from the sovereign power of the State.

The reasoning of Chapter XXVII shows that there is a limit to the use of wage settlements as an instrument of the redistribution of wealth. So long as the initiative in economic affairs is made to depend on profit, a wage settlement which encroaches on profit defeats its own ends. The most that can be done is to prevent wages being depressed below the economic rate.

When we turn to taxation, we find another function of profit imposing a limit. Profit is the principal source of savings. The most productive forms of direct taxation fall largely on profit and therefore encroach on saving. Direct taxation may to some extent be shifted from income to capital. But fundamentally *all* measures directed against profit are in conflict with the essential principle of individualist society. Either we must rely on profit as the motive for

economic enterprise and as the source of accumulation, or we must put something else in its place. And so long as we retain it, we must acquiesce in the accumulation of capital in private hands. Even if a permanent system of taxation of capital could be devised, which would gradually draw away accumulations from the private investor into the hands of the State, and yet would not impair the incentive for accumulation, the acquisition of capital would almost certainly eventually involve the State in the responsibility for the management of industry, and place it in the position of receiving profit. The result would be a transition to collectivism.

The extreme bitterness of the opposition to collectivism or to any less drastic assault on profits is usually imputed to the rich men's love of money. The love of money is certainly a very powerful sentiment, but here, I think, it is not the sole explanation. It is associated with the other great False End, the cult of national power.

There is no reason in the nature of things why a Socialistic policy should not be accommodated to the pursuit of national power, but in practice Socialism is emphatically a policy of welfare and not of power. It aims at diverting profits away from individuals, not in order that the mobile wealth of the country may be concentrated for use against an enemy, but in order that it may be dissipated among the people. Such a policy is in deadly antagonism to the cherished taboos of national power. Strong as is the love of money, people still are inclined to despise money-making; the prestige of money springs from its importance as a constituent in national power.

As a rule, within the limits of one country, the fundamental antagonism of the ideal of welfare and the pursuit of national power is not clearly apparent. So far as immediate ends are concerned, compromise is usually possible. Both aims alike require numerous, healthy, vigorous, well-fed, intelligent people. From both points of view much of the expenditure beyond what may be broadly called necessaries is pure waste, and from both accumulation is desirable.

But as soon as the inhabitants of more than one country are involved, divergence appears. According to the cult of national power it is the duty of every country at least to disregard the interests of the inhabitants of every other, if not actually to injure them. This is what an Italian Statesman has called *sacro egoismo*.[1] Interests here are to

[1] Should it not be translated *Sacré égoisme*, "damned selfishness"?

be interpreted in terms of power, and wealth or territory is to be valued as a constituent of power. No one country can afford to see a rival gain any material advantage over it, for where there is a balance of power any uncompensated advantage may turn the scale and lead to indefinite further encroachments. Any move made by one country is likely to excite competitive action by the others. In such competition a clash may easily transform potential into actual war.

It is because peace is potential war that the risk of actual war is ever present. War has acquired a new and dreadful meaning in the 20th century. It has become possible, as never before in the world's history, to concentrate the resources of a country, human and material, in the single task of wielding organized force. Warlike equipment has become more complex, expensive and destructive. But the essential changes are rather the improvements in transport and in finance. Mechanical transport by rail, road and sea makes it possible to assemble and feed and supply far greater numbers. The modern organization of investment markets and money markets, national and international, enables a Government to get into its hands a far greater command over the available stock and output of wealth than ever before. Thereby it can set free all the more men from productive occupations for military service.

Napoleon in 1812 controlled all Continental Europe except Russia and a part of the Spanish Peninsula, and far the greater part was under his direct rule. The man-power which it was possible for him to distil from these vast dominions provided him with an army of only 500,000 men. By the time he reached his enemy at Borodino he had 120,000 with him. That was the limit of the real fighting force that all Western Europe could put before Moscow in the days when armies travelled on their feet and were supplied by horse transport. The material harm war could do in those conditions, great though it was, was limited.

Nowadays every civilized nation has the power to exhaust its resources in war, and there is no certainty that a decision will be reached short of absolute exhaustion. Europe was desperately near that stage in 1918. Everyone expects that the destructive power and exhausting power of war will grow greater and greater. In this prospect is the most acute antagonism between welfare and national power.

To eradicate war, it is essential not merely to supply the means of settling disputes without violence when they actually arise, but to transform peace into something more genuine than potential war We must hope both for a change

in institutions and a change in people's minds If our reading of the psychological basis of the cult of national power is correct, the change in institutions will bring with it the change in minds For if the cult of national power is ultimately rational, it can be changed by a change in circumstances; an alteration in the premises will lead to an alteration in the conclusion.

Arbitration is not a complete solution. It tends to stereotype existing rights, and, where existing rights obstruct powerful interests, the pressure may become intolerable and break out in violence. Some super-national authority is wanted, with powers analogous to those exercised by a legislature in private legislation. Private legislation is usually directed to such matters as expropriating individuals or modifying their rights in order to make way for public utilities or concessions. A great part of the economic conflicts between nations are ultimately about such matters. If they could be determined otherwise than by sovereign territorial rights, the importance of those rights would be diminished. Vital communications, especially waterways, are already sometimes made the subject of international agreement, and even, like the Danube, regulated by an international body. One country is sometimes secured by treaty access to the sea over the territory of another. An international authority with permanent powers might find much to do in modifying the rigour of sovereign rights whenever they militate against free development

A national legislature with power to over-ride pre-existing law at pleasure and discretion is bound to adopt principles of justice and equity towards individual interests. The principles may be changed from time to time, and the changes may even amount to revolution. At one time the right of slave-owning or the property in rotten boroughs may be suppressed without compensation, at another a communist legislature may sweep away the private ownership of capital and land. A country with a written constitution may, through it, impose prescribed principles of equity upon the legislature. But it is not possible to formulate them except in a very general way. Any formula is certain to be found inappropriate to some unforeseen circumstances, and the most characteristic function of a legislature is to deal with the unforeseen.

In the case of a super-national legislature equitable principles would have to be applied not only to the proprietary rights of individuals but to the sovereign rights of States. To see how Utopian such a conception is, it is only

necessary to conceive of national boundaries in Eastern Europe being carved about like the boundary between Manchester and Lancashire. But it is not necessary to start with a frontal assault upon the most cherished passions of the vain and silly patriots of Eastern Europe.[1] The dominion of European Nations over African and Asiatic races offers quite a wide enough field to make a beginning, and here sovereignty has already been modified at some points by international agreement. Two objects have to be distinguished, the avoidance of conflict between the European nations which possess or seek such dominion, and the preservation and furtherance of the interests of the people over whom dominion is to be exercised. The system of mandates under the League of Nations is intended to attain both objects. It treats sovereignty as a position of trust, primarily in the interests of the people governed, but subject also to the condition that the trustee must not use his power to further his own interests even at the expense of third parties.

It would be folly to be blind to the obvious dangers which beset any scheme for reforming the exploitation of undeveloped countries. Plutocracy is powerful. It would find no difficulty in working through a single super-national authority, instead of through many national Governments, and the safeguards of the interests of the inhabitants might become a sham.

In spite of that, there would be a real advantage in developing the cosmopolitanism of capital. Finance is by nature international; it is compelled to make use of national legislatures and Governments because exploitation depends upon them, but they are in reality a troublesome restriction upon its activities.

Some people may fear that cosmopolitan plutocracy, if given free play, would become too powerful, and would be enabled to tyrannize over all other interests, including those of labour. But if Governments became parochial, and the intensity of the cult of national power were diminished, plutocracy itself would tend in some respects to be weakened. For much of its prestige depends upon the respect which wealth commands as an element in national power. And a part of the antagonism of plutocracy to labour arises from the fear that labour, by encroaching on the surplus of wealth, may weaken the country.

Civilization may be defined as the application of rational

[1] I do not mean to suggest that vain and silly patriots are confined to Eastern Europe.

direction by human volition to the solution of the economic problem. It is characteristic of primitive man that his methods of joint action are imposed upon him by taboos and customs which cannot be altered. Progress only becomes possible by rationalizing these taboos and customs, and relating the means to the end. As this process develops, new ends can be sought, and new means devised. It is the choice of ends and means by human will that is characteristic of civilization. The selection of the individuals to whose wills this choice is to be entrusted is determined by the institutions by which society is governed. They may exercise political authority, whether as representatives, as despots, as officials or in any other capacity. They may be consumers making demand felt through a market. They may be traders planning to make profits. They may be trade unionists or co-operatives working through voluntary associations.

Whoever they may be, their part in a civilized society is to exercise choice. From this point of view a market is a more civilized organization than a customary division of labour and distribution of products, for the market enables the consumer to exercise choice. Within the capacity of the market, what the consumer asks is provided. But the organization through markets is incompletely civilized, because the consumer and producer alike are incompletely rational. They are restricted by their own want of initiative and consequent subservience to tradition and convention.

Consumers form a community in which all are formally independent of one another, and each is yet greatly influenced by the conduct of the others. They are not easily directed as a community. Traders have some power over them, but not unlimited. The power of legislators is more limited still. Occasionally we see the great body of the community moved, as in the War, by a single impulse. Legislative and administrative guidance becomes possible when it is acting in the direction of such an impulse.

But that is exceptional. Under normal conditions the community of consumers has a powerful inertia or momentum which resists the will of anyone who seeks to guide it.

There are other directions where human wisdom is even more helplessly baffled. Among them I would hesitate to include the great problem of cyclical unemployment. To some economists it would appear one of the greatest failures of civilization, but I personally believe it to be remediable by a wise regulation of credit.

But in the course of our survey we have been confronted by several other examples, prominent among which are the

settlement of wages, the prevention of wars, the equitable distribution of wealth and the wise direction of consumption. These are in varying degrees subjects of active controversy, but a common characteristic of them all is that those who seek improvement are baffled by the difficulty of bringing a rational volition to bear upon them. The major task of the economist should be to surmount this difficulty wherever it arises.

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